

**THE INFLUENCE OF CSR REPORTING MODELS ON MANAGERS' CAPITAL
ALLOCATION DECISIONS**

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**THE INFLUENCE OF CSR REPORTING MODELS ON MANAGERS' CAPITAL
ALLOCATION DECISIONS**

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS	iii
LIST OF TABLES	vii
LIST OF FIGURES	viii
LIST OF ABBREVIATIONS	ix
SUMMARY	x
CHAPTER 1: INTRODUCTION	1
CHAPTER 2: BACKGROUND & LITERATURE REVIEW	9
2.1 CSR, Externalities, and Stakeholders	9
2.2 The Growth of CSR	11
2.2.1 CSR and Firm Value	12
2.2.2 The Ethical Case for CSR	17
2.2.3 The Legal Case for CSR	18
2.2.4 CSR Disclosure Requirements	20
2.2.5 Capital Provider Demand for CSR Disclosure	21
2.3 CSR in the Accounting Literature	23
2.3.1 How CSR Influences Internal Firm Behavior	23
2.3.2 CSR Disclosure and its Influence on Capital Providers	25

2.4 CSR Reporting Models	29
2.5 The Manager's Dilemma	31
CHAPTER 3: HYPOTHESES DEVELOPMENT	33
3.1 Accountability	33
3.2 The Social Contingency Model	35
3.3 CSR Reporting Models and Managers' Decisions	40
CHAPTER 4: METHODOLOGY	44
4.1 Experimental Design.....	44
4.2 Experimental Procedure.....	45
4.3 Participants.....	47
CHAPTER 5: RESULTS	50
5.1 Manipulation Check Questions.....	50
5.2 Hypotheses Tests	50
CHAPTER 6: SUPPLEMENTAL ANALYSES	58
6.1 Participant Perception of Stakeholder Preferences	58
6.2 The Relative Influences of Audience and Location.....	61
6.3 Participant Perception of Location's Audience and Content.....	64
6.4 Individual CSR Preferences	65
CHAPTER 7: CONCLUSIONS	68

APPENDIX A: Experimental Instrument – Background (All Conditions)	72
APPENDIX B: Experimental Instrument – Capital Providers/MD&A Condition.....	74
APPENDIX C: Experimental Instrument – All Stakeholders/Sustainability Condition ...	76
REFERENCES	78

LIST OF TABLES

Table 1	Participant Demographic Information	48
Table 2	Participant Capital Allocations	51
Table 3	Reported Accountability	54
Table 4	Participant Beliefs About Stakeholder Preferences	60
Table 5	Reported Influence of Disclosure Audience	63
Table 6	ANOVA Results with CSR Belief Covariate	66

LIST OF FIGURES

Figure 1	Accountability Predictions.....	41
Figure 2	H1 Prediction and Results.....	43
Figure 3	Test of Mediated Moderation.....	57
Figure 4	Influence of Disclosure Audience on Capital Allocations.....	62

LIST OF ABBREVIATIONS

ANOVA	Analysis of variance
B-corp	Benefit corporation
CEO.....	Chief executive officer
CSR.....	Corporate social responsibility
FASAC.....	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
GRI.....	Global Reporting Initiative
H1.....	Hypothesis one
H2.....	Hypothesis two
IRRC	Investor Responsibility Research Center
MBA	Master of Business Administration
MD&A	Management Discussion and Analysis
NGO.....	Non-governmental organization
p-value.....	Probability value
S. D.	Standard deviation
S&P 500.....	Standard & Poor's 500 stock index
SASB.....	Sustainability Accounting Standards Board
SEC	United States Securities and Exchange Commission
US SIF.....	Forum for Sustainable and Responsible Investment
U. S.	United States of America

SUMMARY

In my dissertation, I experimentally examine whether and how the reporting model a firm uses to guide its corporate social responsibility (CSR) disclosures can influence managers' capital allocation decisions. Chapter 1 provides an overview of my research question, why this research question is important, what I predict I will find, and the main results of my experiment. In Chapter 2, I briefly review the CSR literature generally and in accounting specifically, touching particularly on what has catalyzed the recent growth in CSR disclosure, how it influences behavior, and the emerging role of CSR reporting models as well as differences among these models. Two key features that differ among available reporting models are the intended users of the disclosures (e.g., capital providers or all stakeholders) and the disclosure location (e.g., MD&A or Sustainability Report). In Chapter 3, I draw upon research in social psychology on the social contingency model to hypothesize that differences in the intended users and the disclosure location jointly influence the extent to which managers' capital allocations are weighted toward financial versus social benefits. I also hypothesize that this influence is mediated by how accountable managers feel for financial and social performance. Chapter 4 outlines the experimental design and method I use to test my hypotheses. The results of my experiment and related statistical analyses are reported in Chapters 5 and 6, in which I find support for my predictions across two different participant populations I use as proxies for managers. Specifically, I find that participants allocate capital to social benefits across all conditions, but that their overall allocations are largely driven by financial considerations. That is, they weight financial benefits more heavily than social

benefits. However, when the reporting model disconnects CSR disclosure from a more traditional financial reporting setting (i.e., when the CSR disclosures are made to all stakeholders in a Sustainability Report), participants' weight on financial benefits is reduced. In addition, I find that these results are driven by changes in perceived accountability for both financial and social performance. I also find evidence that the influence of the CSR disclosure location is contingent on whether the disclosure audience's preferences are perceived to uniformly favor financial benefits. Chapter 7 concludes and reiterates the important implications of my dissertation. Namely, the results of my study help inform standard setters, regulators, stakeholders, and managers about the consequences of alternative CSR reporting models and highlight the potential effects of CSR disclosure standards on stakeholder welfare.

CHAPTER 1

INTRODUCTION

Traditionally, the manager's role has largely focused on satisfying the interests of capital providers by maximizing profits. However, the recent emergence of corporate social responsibility (CSR) as a mainstream practice is changing this perspective.¹ That is, managers today are giving increased attention to the interests of a broader range of stakeholders whose interests may be relatively more attuned to firms' social performance than their financial performance.² In this setting, managers must often evaluate and make tradeoffs between the benefits and the beneficiaries of their capital allocations. For example, installing smokestack scrubbers can provide a social benefit to some stakeholders (e.g., local communities) by reducing air pollution, but the financial cost to install the scrubbers may negatively impact other stakeholders (e.g., shareholders). As managers evaluate this tradeoff between financial and social performance, their ultimate investment decision can be influenced by a variety of factors. The purpose of this paper is to examine one such factor that has yet to be examined in the CSR literature. Specifically, I examine whether and how the reporting model a firm uses to guide its CSR disclosures influences managers' capital allocation decisions.

CSR reporting models facilitate the CSR disclosure processes by helping managers identify relevant information to disclose and by providing a framework for how the disclosures

¹ Consistent with Davis and Blomstrom (1966), Eilbert and Parket (1973), Fitch (1976), and Hales (2015), I define a CSR activity as an action taken by a business which either mitigates a negative externality or generates a positive externality. Externalities can be categorized based on their impact on society, the environment, etc. However, for ease of exposition, throughout this paper I characterize the impact of all externalities as benefits or costs to society.

² In line with Freeman (1984), I define a stakeholder as any group or individual who can influence or is influenced by the presence or operations of an organization. Stakeholders include investors, lenders, customers, communities, non-governmental organizations, etc.

can be prepared and presented. However, CSR disclosure is largely unregulated (Moser and Martin, 2012), and a number of reporting models have been created with important distinctions among them. Two of the key features that can be used to distinguish these models are the stakeholders the model identifies as the intended users of the disclosures (i.e., the disclosure “audience”) and the report that will serve as the primary disclosure outlet (i.e., the disclosure “location”). With respect to the disclosure audience, some models highlight capital providers as the audience. An advantage of this is that it allows managers’ to focus their disclosures on how CSR activities integrate with the firm’s economic objectives to create value over time. In contrast, other models expand the audience beyond capital providers to include other stakeholders such as communities, customers, etc., so that managers can meet the informational demands of all stakeholder groups.³ Similar considerations hold with respect to disclosure location. For instance, some models advocate integrating financial and CSR disclosures in a financial report (such as MD&A). Alternatively, other models support disclosing in a separate non-financial report (such as a Sustainability Report) which may better distinguish a firm’s social performance from its financial performance.⁴ In this paper, I use an experiment to investigate the implications of these two distinctions among CSR reporting models. More specifically, I investigate whether and how the disclosure audience and location specified by a CSR reporting model jointly influence managers’ capital allocation decisions.

Examining this research question in an experimental setting offers many advantages.

First, an experiment allows me to isolate and manipulate the disclosure audience and location

³ For ease of exposition, throughout the rest of the paper I refer to all stakeholders who are not capital providers (e.g., communities, customers, governments, non-governmental organizations, and suppliers) as “other stakeholders”.

⁴ Different firms refer to the report in which they provide their CSR disclosures by different names. For instance, some refer to it as a Sustainability Report (e.g., BP and General Motors) while others refer to it as a CSR Report (e.g., Cisco and Sony). While some may use these terms interchangeably, throughout this paper and in my experiment, I use the term Sustainability Report.

while holding constant other extraneous factors suggested by prior research to influence managers' capital allocations. These factors include stakeholder pressures, regulatory demands, labor market considerations, firm culture, and competition (for a review, see Kitzmueller and Shimshack, 2012). Second, in an experiment, I can measure and control for individual CSR preferences while reducing the effects of other individual differences by randomly assigning participants to experimental conditions. This is important as prior research suggests individual differences among managers, including managers' CSR preferences, have a significant influence on firms' investments (Agle et al. 1999; Reinhardt et al., 2008; Chin et al., 2013; Parker, 2014). Third, an experiment enables me to mimic an internal decision-making setting for which empirical data is generally not available. In other words, an experiment offers a controlled glimpse into an otherwise empirical "black box". Finally, determining a causal relation between a reporting model and managers' decisions with archival data, if it is available, suffers from endogeneity because firms can generally choose which CSR reporting model they want to follow. I overcome this issue in my experiment by exogenously imposing a reporting model to get at this causal relation and can therefore speak to policy implications in the event that regulators, such as the Securities and Exchange Commission, endorse or mandate a specific reporting model.⁵

The social contingency model of judgment and choice (Tetlock, 1985, 1992) provides a theoretical basis for predicting how managers' capital allocations will be jointly influenced by a

⁵ I also believe my experiment generalizes to present-day settings for at least two reasons. First, the endogenous choice of a CSR reporting model is likely to be sticky, at least in the short run, so long as switching costs are high (Graham et al., 2005). In this case, the reporting model is effectively exogenous from one period to the next. Second, capital allocations pertaining to CSR are made at different levels within a firm, as is the case with firms like Hyatt Regency who decentralize and delegate CSR investment decisions to local and regional managers. In such situations, even if the CSR reporting model is viewed as being endogenous at the firm level, it would likely be exogenous at all lower levels. My research design, therefore, allows me to address not only regulatory policy implications, but also practical implications of individual firm adoption of a reporting model.

disclosure's audience and location. This model is grounded in the social psychology literature (Greenwald, 1980; Baumeister, 1982; Chaiken and Trope, 1999) and has been supported by studies in both psychology (Tetlock 1983; Tetlock et al., 1989) and accounting (Peecher, 1996; Hoffman and Patton, 1997; Dezoort et al., 2006; Gaynor et al., 2006). The social contingency model suggests that, when managers are accountable to a salient stakeholder audience, the perceived preference of the audience will factor heavily in managers' decisions for at least two reasons. The first is that managers are motivated to protect and improve their social status and image (Greenwald, 1980; Baumeister, 1982). One way managers can do this is by making decisions that are at least defensible to their audience, but that would ideally gain their audience's approval. The second is because conforming to the audience's preference reduces the cognitive effort managers' are required to exert to make the decision (Fiske and Taylor, 1991; Chaiken and Trope, 1999).

Drawing on the social contingency model, I propose that the perceived preference of the CSR disclosure audience will influence managers' capital allocations. Specifically, I expect managers directing their disclosures to a capital-provider audience will anticipate that capital providers will tend to prefer financial benefits over social benefits. Managers will therefore feel relatively more accountable for financial performance than social performance. As a result, they will increase their investment in projects that maximize financial benefits because doing so is a cognitively easy way of making a decision that is likely to gain the approval of capital providers. However, when managers consider the conflicting preferences for financial and social benefits of a stakeholder audience that includes capital providers and other stakeholders ("all stakeholders"), the audience-preferred investment is less clear. In this situation, I expect that managers will be more likely to consider additional information such as the disclosure location to help identify a

defensible decision. Consequently, when disclosing CSR information to all stakeholders in a financial report, I expect managers' will feel relatively more accountable for financial performance than social performance and increase their investments in projects that are expected to generate higher financial returns. Conversely, when disclosing CSR information to all stakeholders in a non-financial report, I expect managers' will feel relatively more accountable for social performance than financial performance and increase their investments in projects that are expected to generate more social benefits.

I test my predictions using a 2x2 between-participants experiment by manipulating disclosure audience (capital providers vs. all stakeholders) and disclosure location (MD&A vs. Sustainability Report). I use participants in a MBA class as proxies for CEO's of a public company. Their primary task in my experiment is to evaluate two potential projects (A and B) and allocate a fixed amount of capital between them. Both projects produce a positive financial benefit to the firm and a positive social benefit, but they differ in one important way. Namely, project A exceeds the company's financial hurdle rate but falls short of the firm's social goal while project B falls short of the company's financial hurdle rate but exceeds the firm's social goal. Therefore, this design enables me to analyze whether and how the weights participants place on financial and social benefits change based on the CSR disclosure audience and location when a firm's financial and social goals conflict.

The results of my experiment suggest that the CSR reporting model a firm uses does affect managers capital allocations and that this effect is driven by how accountable managers feel for financial and social performance. Specifically, when the reporting model links CSR disclosure with financial objectives (i.e., when CSR disclosure is directed to only capital providers and/or is provided in MD&A), participants allocate more capital to the project that

maximizes financial benefits rather than social benefits because they feel relatively more accountable for financial performance compared to social performance. However, when the reporting model disconnects CSR disclosure from a traditional financial reporting setting (i.e., when CSR disclosure is directed to all stakeholders in a Sustainability Report), the difference between how accountable participants feel for financial and social performance is mitigated as is the difference in their capital allocations to projects that emphasize financial and social benefits.

I also find support for the theory underlying the social contingency model. As predicted by the model, I find evidence that the influence of the CSR disclosure location is contingent on the preferences of the disclosure audience. When the intended audience was perceived to have a largely uniform preference for financial returns over social benefits, manager participants indicated that their capital allocations were more influenced by the disclosure audience than the location of the disclosures. However, when the intended audience was perceived to have diverse preferences for financial vs. social investments, participants indicated that their allocations were more influenced by where the disclosures would be reported rather than who the disclosures were addressed to.

At a broad level, this research speaks to how reporting models that guide firms' CSR disclosure can have real effects on firm behavior. That is, rather than being merely a medium for external reporting, accounting disclosure can also affect managers' internal decision-making. Given the billions of dollars firms collectively spend on CSR-related activities annually, my study suggests that a CSR reporting model can have real economic consequences for firms and stakeholders.⁶ Specifically, by shifting the weights managers place on financial and social

⁶ Smith (2014) estimates that global corporate spending on philanthropic activities exceeds fifteen billion dollars annually. Importantly, this figure can be viewed as a floor for actual CSR-related spending because it does not include spending that provides any financial benefit to the corporation.

benefits, a CSR reporting model can alter both the benefits and beneficiaries of managers' capital allocations. Therefore, this study should be of practical interest to both managers and stakeholders.

Understanding how different reporting models influence managers' capital allocations has implications for current and future practice. Recently, there has been a surge in public concern about social issues, and this surge has spurred a greater demand for CSR disclosure (Ioannou and Serafeim, 2012). In response to this demand, a growing number of regulators and stock exchanges are instituting mandatory CSR disclosure requirements (KPMG et al., 2013; European Union, 2014). In addition, in the absence of comprehensive CSR disclosure guidance from regulators, standard setters are creating reporting models for firms to use to guide their CSR disclosure (KPMG et al., 2013). These developments have resulted in a great deal of variation in CSR disclosure. While standard setters and regulators are expressing a desire to harmonize these varying models and requirements (KPMG et al., 2013), there is a surprising paucity of research on the implications of existing divergent disclosure practices to inform both the harmonization process (Ioannou and Serafeim, 2012; Hales, 2015) and managers about their CSR reporting model decisions. This paper helps to fill this void by providing evidence about how disclosure audience and location, two key differences among reporting models, affect managers' capital allocation decisions.

One specific implication of this research is that disclosure audience and location do not completely eliminate managers' investment in either financial or social benefits, but can tilt the balance of benefits in favor of one over the other. To the extent regulators seek to use CSR disclosure as a mechanism to influence corporate investment, this study should be informative. For instance, if regulators want to maximize the benefits to society derived by corporate

investments, they may want to consider instituting or endorsing a reporting model in which CSR disclosures are made in a report separate from existing financial disclosures and are not directed to an exclusive capital-provider audience.

This study contributes to the growing CSR literature. Among other things, prior studies on the determinants of CSR investment have examined whether firms seek to use CSR as a way to attract employees, cut costs, differentiate from competitors, attract customers, improve financial performance, and signal future financial performance (Kitzmueller and Shimshack, 2012; Lys et al., 2014). Prior studies have also looked at social activism (Davidson et al., 1995; Klein et al., 2004; Kitzmueller and Shimshack, 2012) and firm ethicality (Kim et al., 2012; Hoi et al., 2013) as determinants of CSR investment levels. My study adds to this literature by introducing CSR disclosure as a determinant of the allocation of benefits derived from CSR investment. In doing so, I answer the call for additional accounting research on the consequences of CSR disclosure (Moser and Martin, 2012).

My results also help build a theoretical understanding of *how* CSR reporting models influence managers' decisions. I provide evidence that CSR reporting models influence how accountable managers feel for financial and social performance which affects their subsequent decisions. I also find that the effect of disclosure location on managers' decisions depends on the preferences of the disclosure audience. This finding suggest that when firms, standard setters, and regulators evaluate alternative reporting models, they should perhaps first consider which disclosure audience they would like to prioritize and make disclosure location a secondary consideration. In addition to informing firms, standard setters, and regulators, this study should also be of interest to academics conducting CSR research in a managerial context as it increases our understanding of how reporting models can influence managers' decisions.

CHAPTER 2

BACKGROUND & LITERATURE REVIEW

2.1 CSR, Externalities, and Stakeholders

Corporate social responsibility, or CSR, is not a well-defined term and there is little agreement about what the definition should be (Carroll, 1999; Freeman and Hasnaoui, 2011). In fact, some argue that it simply cannot be defined because it is a concept that has been socially created (Dahlsrud, 2008) and is dependent on contextual factors that differ across societies and nations (Gjolberg, 2009). Despite these challenges, many CSR definitions have been proposed. Among these, there seems to be general agreement that, foundationally, CSR consists of corporate actions that advance social (including environmental) interests.

Some definitions, however, layer additional stipulations on to this foundation (see Carroll, 1999, and Freeman and Hasnaoui, 2011). For example, some definitions require that, to be considered CSR, corporate actions cannot be motivated by financial profits (e.g., Manne and Wallich, 1972; Baron, 2001) and must even be costly to the firm (e.g., Manne and Wallich, 1972; Reinhardt et al., 2008; Benabou and Tirole, 2010), implying that CSR is wholly altruistic. In contrast, other definitions proposed by both academics (e.g., Davis, 1960; Johnson, 1971; Carroll, 1979; Drucker, 1984; Jensen, 2001; Hales, 2015) and institutions (e.g., the World Bank, the United Nations, and the European Commission) make room for corporate profits.⁷ That is, these definitions acknowledge profitability and economic viability as a form of social

⁷ The CSR definitions for the World Bank, United Nations, and European commission are available at http://info.worldbank.org/etools/docs/library/57434/publicpolicy_econference.pdf, <http://www.unido.org/en/what-we-do/trade/csr/what-is-csr.html>, and <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF>, respectively.

responsibility (Carroll, 1979), that corporate actions to address societal issues can be seen as opportunities for profitable innovation (Drucker, 1984), and that CSR can be value-enhancing in the long-term (Davis, 1960; Johnson, 1971; Jensen, 2001). A second stipulation some definitions make is that, to be considered CSR, corporate actions must go beyond the firm's current economic and legal requirements (e.g., McGuire, 1963; Walton, 1967; Manne and Wallich, 1972; Davis, 1973; Sethi, 1975; Carroll, 1979; Jones, 1980; McWilliams and Siegel, 2001; Kitzmueller and Shimshack, 2012). According to this stipulation, despite the social or environmental good that may be produced by corporate actions, these actions do not constitute CSR unless they go above and beyond what the firm is required to do.

For the purposes of this paper, I follow an approach similar to Davis and Blomstrom (1966), Eilbert and Parket (1973), Fitch (1976), and Hales (2015) and remain silent as to firm motives and obligations, defining CSR more generally as any action taken by a corporation that benefits society by mitigating a negative externality or generating a positive externality. In doing so, I acknowledge the broad spectrum of potential CSR activities that this definition allows and that some actions can be more socially responsible than others (i.e., they do more good for society than others). Nevertheless, I consider CSR as a corporate action that provides benefits to society in the form of a positive externality and/or a reduction of an existing negative externality.⁸

Consistent with Buchanan and Stubblebine (1962), I define an externality as either a benefit received or a cost borne by stakeholders who did not choose to receive that benefit or incur that cost. A negative externality is one that imposes a cost on stakeholders. For example, a

⁸ Regarding negative externalities, this definition is not intended to limit CSR for a company to only reducing the negative externalities it is responsible for creating. Rather, CSR can include reducing negative externalities created by other entities as well.

factory that releases pollution into the atmosphere creates a negative externality for local communities who must now bear the medical costs and other costs associated with lower air quality. In contrast, when an externality creates a benefit for stakeholders, it is a positive externality. For example, a company that builds a new factory creates jobs and tax revenues for local communities and may invest in local infrastructure to the benefit of the community as well as the company. There are many different kinds of positive and negative externalities that companies can create, and these can arise from a host of issues pertaining to, for example, community relations, corporate governance, supply chain management, product safety, waste generation, resource consumption, employee relations, human rights, globalization, climate change, and environmental management.

Externalities can impact a variety of different types of stakeholders. By stakeholders, I mean any group or individual who can influence or is influenced by the presence or operations of an organization (Freeman, 1984). Individual stakeholders are commonly categorized into broader stakeholder groups, including capital providers (i.e., shareholders and lenders), customers, governments, employees, communities, non-governmental organizations (NGOs), and suppliers. As implied by the definition, each of these stakeholder groups is affected by corporations, has the ability to influence corporations, or both.

2.2 The Growth of CSR

Even though the practice of CSR has only recently become broadly popular, it is not a modern concept. Rather, it has been discussed, researched, and practiced for centuries (Carroll, 1999). While there are many potential explanations for the recent emergence of CSR, I will elaborate on five in the sections that follow. These explanations include the theoretical and

empirical link between CSR and firm value, ethics, the corporate legal environment, the CSR disclosure landscape, and capital provider demand.

2.2.1 CSR and Firm Value

One explanation for the growth in CSR practices is the theoretical and empirical connection between CSR and the economic performance of the firm which has helped align managers', shareholders', and society's interests (Lee, 2008). Collectively, CSR research since the 1990's helps identify why CSR can be in the interests of both the firm and its stakeholders because, in addition to benefiting society, it can boost firm value by increasing revenues, decreasing costs, and mitigating risks.

An area that has received a great deal of attention from researchers is how CSR affects the labor market. From a hiring perspective, CSR acts as a signal to potential employees of the values and culture within a firm (Fombrun and Shanley, 1990; Balakrishnan et al., 2011). As such, CSR can reduce information asymmetry and decrease firm costs associated with finding prospective employees that will function well within a company's culture (Brekke and Nyborg, 2004). However, not only can CSR help create better employee–employer matches, but it can also help firms gain a competitive advantage over competitors because a CSR firm appears more attractive to job applicants (Turban and Greening, 1997; Backhaus et al., 2002). Specifically, CSR can send a positive signal about the attractiveness of a firm as an employer and increases the probability that job applicants will pursue and accept a job from a CSR firm compared to a non-CSR firm (Greening and Turban, 2000).

Other labor market advantages CSR firms have pertain to existing employees and are related to employee commitment, effort, and compensation. Peterson (2004) provides survey evidence that the perceived ethics of CSR strengthens the commitment between the employee

and employer, even more so than financial remuneration. In an accounting experiment, Balakrishnan et al. (2011) report that CSR (in the form of corporate donations to charity) motivates employees to altruistically increase their effort levels for the firm, despite the fact that corporate donations reduce the firm resources available for employee consumption. Thus, it appears that CSR can reduce the indirect labor cost to firms associated with monitoring employee effort. Furthermore, there is theoretical support for the notion that employers may be able to pass along some of the cost of CSR to employees in the form of lower wages when employees have preferences for CSR (Kitzmueller and Shimshack, 2012). There are also other potential indirect benefits to firms' CSR efforts. Consider the example of the firm that gives its employees paid time off to work on socially beneficial projects in the local community. Employee participation in these kinds of volunteer programs can pay long-term dividends to companies in the form of employee skill development in areas such as leadership skills and strategic vision (Needleman, 2008).

In addition to labor market benefits, consumer reactions to CSR can also directly bolster a firm's market value (Lev et al., 2006). For instance, CSR can help firms differentiate their products and services from their competitors (Navarro, 1988; Sprinkle and Maines, 2010) and can enhance customer loyalty (Sen and Bhattacharya, 2001; Bhattacharya and Sen 2003), both of which can potentially increase top-line revenues. There is also evidence that, not only can CSR make some products and services more attractive, but also that some consumers are willing to pay a premium for these outputs.⁹ For example, surveyed coffee consumers state they are willing to pay a premium for sustainably-sourced coffee relative to coffee from less sustainable sources

⁹ However, as Kitzmueller and Shimshack (2012) note, it is also possible consumers' willingness to pay a premium, as documented in studies that provide survey evidence, may be driven by a subset of consumers with strong preferences for CSR.

(Loureiro and Lotade, 2005). Similarly, many consumers pay a premium cost for “green” energy from sustainable sources (Roe et al. 2001) and higher rents for office spaces in sustainable buildings (Eichholtz et al., 2010).

Another value-relevant benefit of CSR is that it can help companies identify and mitigate potential long-term risks. From a risk-management perspective, there is empirical evidence that firms can use CSR to figuratively purchase goodwill from stakeholders to insulate them from value-destroying stakeholder reactions to negative firm events (Richardson et al., 1999). In this sense, CSR can act as an insurance policy to prevent the loss of firm value. However, only certain forms of CSR appear to be effective at purchasing this type of stakeholder goodwill. Specifically, CSR activities that benefit society rather than capital providers seem to be effective insurance policies against future negative stakeholder reactions (Godfrey et al., 2009).¹⁰

CSR can also theoretically help firms manage risks pertaining to stakeholder activism (Baron, 2001; Baron and Diermeier, 2007). For an activist intervention to be effective, activists rely a great deal on the court of public opinion. By engaging in CSR, firms can enhance their social image and make themselves a more challenging and costly target of activist attention relative to their competitors, thereby reducing the likelihood of an intervention. Stakeholder activism is not uncommon and can be concerning for corporations (Kitzmueller and Shimshack, 2012). It is quite costly and often results in economically significant stock price declines among targeted companies (Pruitt and Friedman, 1986; Pruitt et al., 1988; Davidson et al., 1995). Thus,

¹⁰ Looking at empirical data, Godfrey et al. (2009) find that CSR that influences secondary stakeholders function like an insurance policy against negative stakeholder reactions to negative firm events but that CSR that influences primary stakeholders does not. Following Freeman et al. (2008), Godfrey et al. (2009, p. 429) identify primary stakeholders as those who are “essential to the operations to the business” and who “can make legitimate claims on the firm and its managers and have both urgency and power...to enforce those claims” while secondary stakeholders are those who “can influence primary stakeholders” and have “legitimate claims on the firm, but lack both urgency and power to enforce those claims.”

it isn't surprising that companies often take actions (both preemptive and reactive) to mitigate these risks (Davidson et al., 1995; Eesley and Lenox, 2006).

Another risk that voluntary CSR can help companies mitigate pertains to regulatory intervention. For instance, a company can voluntarily reduce its carbon emissions in an effort to avoid mandatory carbon-reducing regulations that may be more costly and stringent. Regulatory intervention can be more costly than stakeholder activism on firm behavior (Khanna and Anton, 2002; Delmas and Toffel, 2008), and there is evidence to suggest that preemptive corporate actions that involve CSR can effectively mitigate regulatory intervention (Bandyopadhyay and Horowitz, 2006; Shimshack and Ward, 2008). In fact, pre-emptive CSR can even produce positive subsequent benefits for companies such as less future oversight by regulators (Innes and Sam, 2008) and faster regulatory approval times (Decker, 2003).

Beyond risk management, CSR has helped some firms identify opportunities to innovate which can create both operational efficiencies and revenue growth. One example of innovative CSR is provided by the waste management practices of Procter & Gamble. Motivated by CSR, Procter & Gamble found it can reduce the waste created by its manufacturing processes by converting it into raw materials and selling it to other companies. In this way, CSR has helped Procter & Gamble to both reduce its waste and increase its revenues. In fact, Procter & Gamble reports that seven years of this innovative practice has generated \$1.6 billion in "value" for the company.¹¹

While there are many ways for firms to potentially benefit from engaging in CSR activities, rigorous empirical evidence on the relationship between CSR and firm value is far

¹¹ See http://www.pg.com/en_US/sustainability/environmental_sustainability/worth_from_waste.shtml.

from conclusive. A large number of studies have attempted to examine this issue. In a meta-analysis of 251 of these studies, Margolis et al. (2009) report only a very modest positive correlation between CSR and corporate financial performance. Specifically, 28% of the studies they examined report a positive correlation, 2% report a negative correlation, 59% report no correlation, and 10% do not report statistical results. Additionally, Margolis et al. (2009) declare that the driving factor behind the overall positive correlation is indeterminable. That is, it could just as easily be that positive financial performance drives CSR and not the reverse. This interpretation is consistent with Lys et al. (2014) who report that strong financial performance leads to greater subsequent CSR activity. They therefore conclude that CSR disclosure is a management signal of strong future company performance.

Recently, Eccles et al. (2014) attempted to address the issue of causality in their study by observing a long lag period between the independent and dependent variables of CSR performance and firm value, respectively. However, rather than just look at CSR performance levels generally, Eccles et al. (2014) differentiated between firms that integrated CSR into their institutional processes and strategies (high CSR companies) and those that did not (low CSR companies). They then match-paired 90 high-CSR companies with 90 similar low-CSR companies and compared the stock market and accounting performance of these pairs over an 18-year span. Eccles et al. (2014) report that high-CSR companies significantly outperformed low-CSR companies in terms of both stock market returns and accounting performance. In a similar vein, Khan et al. (2015) and Cheng et al. (2015) provide evidence about how strategic investment in CSR projects that 1) are relevant to both corporations and stakeholders and 2) are relatively more likely to be impactful (i.e., material) to the corporation perform in the stock

market.¹² Khan et al. (2015) found that companies who strategically directed capital to material CSR projects and diverted capital from immaterial CSR projects performed the best, suggesting that CSR materiality is an additional moderator between CSR and firm performance.

Interestingly, however, they also find that firms who invested in immaterial CSR projects performed similarly to firms who did not invest at all, suggesting that, at a minimum, even investment in immaterial CSR projects may not destroy firm value. Thus, to the extent research finds a strong positive correlation between CSR and financial performance, it could indicate that managers are strategically picking which CSR projects they believe will be financially beneficial (Reinhardt et al., 2008). Notwithstanding this evidence, the issue of reverse causality remains, such that it is unclear whether CSR investments provide positive firm benefits, on average, or whether managers of financially successful firms are more likely to engage in CSR activities.

2.2.2 The Ethical Case for CSR

A second explanation for the increased presence of CSR is that it is widely seen as the right thing to do and part of being a good corporate citizen. Given that most of the CSR activities that companies engage in are voluntary, this explanation for CSR has been characterized by some as altruism (Benabou and Tirole, 2010; Sprinkle and Maines, 2010). Altruism aligns well with the view of many of the early CSR theorists that were discussed above who define CSR as a company's "obligation" (Bowen, 1953; Davis and Blomstrom, 1966; Jones, 1980) or "responsibility" (Steiner, 1971; Carroll, 1979).

¹² The materiality construct used by Khan et al. (2015) is based on the Sustainability Accounting Standards Board's (SASB) concept of materiality. To identify material CSR activities within each industry, the SASB has been working with and identifying topics that are of interest to corporations, capital providers, and other stakeholders. They then collect information about the level of interest in each of the CSR activities, and the potential of these activities to affect corporate financial performance and future corporate performance.

It is challenging to disentangle profit-motives from altruistic motives for CSR, but there is evidence that altruism drives at least some of the CSR activities companies engage in. Sprinkle and Maines (2010) provide specific examples of CSR which are unlikely to be explained by profit motives. They point out that Merck has donated billions of medicinal tablets in an effort to fight river blindness in Africa, Latin America, and the Middle East with little to no direct benefit to themselves. They also point to evidence that many companies have anonymously provided disaster relief donations and supplies to help alleviate suffering and rebuild communities affected by natural disasters. As further evidence of the existence of altruistic motives, 58% of managers at the largest 250 revenue-generating firms in the world reported that ethical considerations motivate their CSR activities (KPMG, 2011). In fact, the frequency of the survey responses about ethical considerations was second only to reputation concerns.

2.2.3 The Legal Case for CSR

A third explanation for CSR practices among firms in the U.S. pertains to the legal environment, which has changed over time. In the U.S., managers' overarching legal responsibilities to shareholders can be summarized by their fiduciary duties of care and loyalty. To fulfill the duty of loyalty, managers must act in the best interests of the corporation in good faith (Strine et al., 2010). The duty of care requires managers to "exercise that degree of skill, diligence, and care that a reasonably prudent person would exercise in similar circumstances" (Clark, 1986, p. 123). If managers violate these two duties they open themselves up to personal liability.

Through the first half of the 20th century, managers' fiduciary duty was limited to the shareholder view of corporate assets, which is that managers' actions must be in the shareholders' best interests (Fry et al., 1982). This view restricted managers' ability to engage in

CSR with respect to practices like making charitable donations because they were not perceived to be in shareholders' best interests. However, this largely changed as a result of a 1954 New Jersey Supreme Court ruling that abandoned the shareholder view. That is, the ruling opened the door for corporations to make charitable donations "without regard to any strict relation to stockholders' interests" (Fry et al., 1982, p. 95). Since then, all 50 states have adopted similar positions and recognize that corporations have a right to donate corporate assets to charity (Reinhardt et al., 2008).

The New Jersey Supreme court ruling was pivotal in paving the way for subsequent CSR practices. Since that ruling, the courts have largely deferred to managers' judgment of what is in the best interests of the corporation when it comes to CSR activities like charitable donations. This judicial practice, known as the business judgment rule, largely presumes that managers are better able to discern what is in the best interests of the company than are the courts. As a result, judges grant managers a great deal of latitude when it comes to CSR—even in extreme cases (Branson, 2002). One notorious example of just how far the courts' deference to managers' judgment goes is a case tried in Delaware in 1989. The then CEO of Occidental Petroleum, Armand Hammer, had donated \$120 million of Occidental's assets for the construction of an art museum to be named after him. This amount was equivalent to almost one-half of the company's annual net profits. Based on the business judgment rule, the court refused to intervene on behalf of the shareholder plaintiffs (Reinhardt et al., 2008). In spite of this extreme example, however, protection from the business judgment rule is not limitless and requires that, when challenged, managers be able to make a plausible argument that their decisions and actions were made in good faith and are in the best long-term interests of the firm.

Given the recent research discussed above that positively links CSR to long-term firm value—or at a minimum, the absence of financial harm—there is likely to be an even stronger legal case for CSR today than in the past. Notwithstanding being on solid legal footing, some companies (like The New York Times) who wish to engage in CSR have taken the additional steps of placing provisions in their corporate charters to authorize themselves to use company assets for CSR activities (Reinhardt et al., 2008). Another option for businesses that wish to engage in CSR is to incorporate as a benefit corporation (B-corp). The specific purpose of a B-corp is to positively and materially impact society and, as a result, B-corp status offers explicit protections for companies to engage in CSR. Specifically, B-corp law expands the duties of managers to include both financial and non-financial stakeholders and therefore requires managers to report on their company’s CSR activities (Clark Jr. et al., 2013). Currently, there are over 1,200 B-corps worldwide, including recognizable companies such as Ben & Jerry’s Ice Cream, Etsy, and Patagonia.¹³

2.2.4 CSR Disclosure Requirements

A growing number of regulators and standard setters are instituting mandatory CSR disclosure requirements. To illustrate, in 2014 the European Union issued a directive which will require approximately 6,000 companies based in European Union member states to disclose specific environmental, social, and governance information, beginning in 2017 (European Union, 2014).¹⁴ As further evidence, in a non-exhaustive sampling of current national CSR disclosure guidelines, KPMG et al. (2013) identify 134 mandatory disclosure requirements across 42

¹³ B-corps are currently legal in 27 states (and the District of Columbia). Legislation to establish B-corps has been introduced in 12 additional states. Further information about B-corps is available at <https://www.bcorporation.net/>.

¹⁴ This European Union directive pertains only to companies with more than 500 employees. While it outlines specific information to disclose, it gives each company the flexibility to select which CSR reporting model it wishes to use.

nations.¹⁵ For example, Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act passed by the U. S. Congress in 2010 requires certain firms to report on the measures they are taking to determine whether conflict minerals are entering their supply chain. KPMG et al. (2013) also identify 13 nations—including China, India, Russia, Brazil, and France—where more extensive CSR disclosure is required for state-owned businesses. Stock exchanges are also getting involved by mandating CSR disclosure as a listing requirement and by providing CSR disclosure guidance for its listed companies. According to the Sustainable Stock Exchanges Initiative, at least five stock exchanges currently require some form of CSR disclosure to be listed (the Johannesburg, Shanghai, Malaysian, London, and Shenzhen Stock Exchanges), while nineteen exchanges encourage CSR disclosure and provide formal guidance on what CSR information to disclose (SSE, 2012).

Based on the notion that what gets measured gets managed, the CSR disclosure requirements imposed by regulators, standard setters, and stock exchanges provide a fourth explanation for the recent expansion of CSR practices. In other words, as the CSR disclosure requirements have increased over time, firms are likely averse to disclosing unfavorable information about their CSR performance. As a result, firms who were previously poor CSR performers likely increased their CSR activity to avoid potential negative shocks to their public image.

2.2.5 Capital Provider Demand for CSR Disclosure

In addition to the requirements imposed by regulators, standard setters, and stock exchanges, a fifth explanation for the growth of CSR is that an increasing number of capital providers are demanding that firms be sustainable and provide information about their CSR

¹⁵ Given the casual nature of this survey by KPMG et al. (2013), this figure could be seen as the lower bound for the number of mandatory CSR disclosure requirements that actually exist in these 42 nations.

practices. This demand is evidenced in a number of ways. For instance, US SIF (2014) reports that since 2012, the inclusion of CSR performance in investors' investment criteria has increased 76% and that almost 1 in 5 dollars invested in managed funds in the U.S. is invested based on this criteria. As further evidence, Johnson (2015) reports that in 2014, 47% of all proxy proposals were related to CSR issues (including political lobbying), which was up from 37% in 2013. In addition, the Financial Accounting Standards Advisory Council (FASAC) surveyed its stakeholders in 2013 to learn what projects they would like the Financial Accounting Standards Board (FASB) to prioritize. FASAC (2013) reports that, while CSR disclosure did not make the top ten priorities overall, it was listed by a number of stakeholders and was even listed as a top-five priority by some.¹⁶

Dhaliwal et al. (2011) provide further evidence of investors' demand for (and use of) CSR information. In their study, Dhaliwal et al. found that, conditional on company CSR performance being strong, investors incorporated CSR information into their investment decisions and rewarded disclosing companies by requiring a lower rate of return on their capital. Thus, companies who perform better than their peers with respect to CSR and disclose CSR information may enjoy a reduced cost of equity capital. Further, Dhaliwal et al. (2011) and Dhaliwal et al. (2012) also provide evidence that analysts use CSR disclosure to make decisions and that it can reduce analysts' forecast errors. Similarly, Matsumura et al. (2014) provide evidence that the market prices firms' carbon emission disclosures and has punished firms who emit by an average of over \$200,000 per every 1,000 metric tons of carbon. Furthermore, they

¹⁶ One of the roles of the FASAC is to "advise the [FASB] on future project priorities and on possible new agenda items" (FASAC, 2013, p. 3). The FASAC stakeholders surveyed include "31 current FASAC members, 13 current members from other FASB advisory groups (including members of the Not-for-Profit, Investor, and Small Business Advisory Committees and the Private Company Council), 6 FASB Board members, and 55 other stakeholders" (FASAC, 2013, p. 3) whose backgrounds include accounting practitioners, business managers, academics, shareholders, and lenders.

also report that firms who did not report this information were punished relative to firms who disclosed.¹⁷ So in summary, there seems to be growing evidence that shareholders are demanding firms engage in CSR and provide information about their CSR performance, and that shareholders put a value on this information and factor it into their investment decisions.

2.3 CSR in the Accounting Literature

Coinciding with the popularization of CSR disclosure, attention to CSR research has increased in accounting academia. Because accounting research particularly focuses on issues pertaining to things like employee contracting and shareholder reaction to firm disclosure, it offers unique insights and makes important contributions to the overall CSR literature. In the two sections that follow, I briefly discuss and summarize some of these more recent contributions.

2.3.1 How CSR Influences Internal Firm Behavior

One theory about CSR from the management literature suggests that CSR activities provide managers with political and social capital that can help insulate managers against negative events (Godfrey et al., 2009). If true, this has important implications because it suggests that as managers participate in CSR activities they may feel shielded from negative repercussions stemming from other actions they take. Therefore, they may feel more licensed to engage in opportunistic behavior that benefits themselves at the expense of other stakeholders. This theory suggests a positive association between the level of engagement in CSR and various forms of unscrupulous behavior within the same firm. However, as I will illustrate below, a number of accounting studies have found the opposite to be the case.

¹⁷ Other accounting studies provide evidence that the market finds CSR disclosures informative. Specifically, Anderson and Frankle (1980), Al-Tuwaijri et al. (2004), Griffin and Sun (2013), and Plumlee et al. (2015) report finding a positive link between a firm's CSR disclosures and its stock returns.

Gao et al. (2014) investigated the relation between CSR and insider trading and report that as CSR activity increased insider trading decreased. Furthermore, they found that this negative relationship grew stronger among managers who were publically associated with the firm's CSR image and also among managers whose compensation was more closely tied to firm value. So in contrast to the theory cited above that would suggest a positive relation between CSR and insider trading, these findings are consistent with the idea that CSR makes managers more sensitive and aversive to engaging in activities that can damage the reputational and economic capital they gain from their association with CSR. That is, CSR may make negative activities like insider trading appear more costly rather than less costly to managers. Importantly, in addition to finding evidence of an economic explanation for their results, Gao et al. (2014) also provide evidence that individual manager preferences strengthened the negative correlation they detected between insider trading and CSR and that this behavior was not attributable to corporate governance. Thus, there appears to be both economic and personal motives at work driving the negative association between CSR and insider trading. This personal motive is consistent with Martin and Moser (2014) who report that managers in an experimental market exhibited utility for CSR and were willing to bear a cost to facilitate it.

Likewise, multiple accounting studies provide evidence that CSR activity is negatively correlated with another specific kind of behavior which can be construed as devious: aggressive tax practices (Lanis and Richardson, 2012; Hoi et al., 2013). However, evidence from Watson (2015) suggests that this behavior is moderated by the firm's financial performance. That is, Watson (2015) found that when firms performed well financially, firms who tended to be more socially responsible took less aggressive tax positions, but when these firms performed poorly financially there was no difference between their tax aggressiveness and that of firms who were

less socially responsible. In a similar vein, Kim et al. (2012) report that, in their sample, the level of CSR activity was negatively associated with real and accrual earnings management as well as SEC investigations. However, this isn't to say that managers of CSR firms don't manage earnings. A recent working paper by Barton et al. (2014) explores the motives of managers at CSR firms compared to non-CSR firms for managing earnings. They found that CSR managers were more likely to do so when it benefitted external stakeholders (i.e., shareholders) but not when it benefitted themselves. In other words, CSR managers do manage earnings, but it is apparently not motivated solely by individual opportunism.

2.3.2 CSR Disclosure and its Influence on Capital Providers

To illustrate the exponential growth of voluntary CSR disclosure over the last two decades, KPMG (2013) reports the results of a survey of the largest 250 revenue generating firms in the world, and the 100 largest revenue generating firms in each of 41 different countries. The survey reveals that 93% (71%) of the world's largest 250 (4,100) firms currently disclose CSR information compared to 0% (12%) in 1993. Accounting research provides important insights about how CSR performance relates to voluntary CSR disclosure and how this disclosure influences market participants.

As a starting point, a number of accounting studies (e.g., Cowen et al., 1987; Deegan and Gordon, 1996; Holder-Webb et al., 2009; Gamerschlag et al., 2011; Chan et al., 2014) have examined the determinants of voluntary CSR disclosure. These studies report that larger firms, more profitable firms, and firms with more capital provided more CSR disclosure. These findings may indicate that, because CSR disclosure is costly, firms with greater resources are better able to bear these costs. Relatedly, these studies report that firms with greater media coverage provided more CSR disclosure. This could be because firms in the media spotlight are

simply bigger and therefore have greater resources or because they face greater stakeholder pressure to be socially responsible due to their increased visibility. Finally, these studies also find better corporate governance as well as industry membership have influenced CSR disclosure, evidenced by firms in industries that typically create more pollution (e.g., the chemical, automotive, and utility industries) providing relatively more CSR disclosure.

There are competing theories that predict how CSR performance in the prior period(s) will relate to current CSR disclosure. On one hand, voluntary disclosure theory (Verrechia, 1983; Dye, 1985) predicts a positive correlation because socially responsible companies may want to distinguish themselves from those who aren't socially responsible. On the other hand, socio-political theories (Gray et al., 1995; Patten, 2002) predict a negative correlation because companies who are not socially responsible may increase their disclosure volume to try to persuade stakeholders that they are responsible. In an attempt to distinguish between these competing theories, Clarkson et al. (2008) provide some evidence in support of both theories. That is, they report that good CSR performers disclosed more CSR information overall than bad CSR performers, supporting voluntary disclosure theory. However, when they broke down the CSR disclosures into verifiable (i.e., hard) disclosures and non-verifiable (i.e., soft) disclosures, they found that firms who performed poorly with respect to CSR in the prior period were more likely to make "soft" CSR disclosures, including declarative statements about their commitment to being socially responsible. Thus, it appears that socio-political theory may be more applicable with respect to soft disclosures but voluntary disclosure theory is relatively more applicable for CSR disclosure in general.

The findings of Clarkson et al. (2008) with respect to "soft" CSR disclosure can be interpreted as strategic disclosure. This interpretation is consistent with Martin and Moser (2014)

who designed a laboratory market in which managers chose what information, if any, to disclose to shareholders about a costly CSR project. They report that managers were more inclined to provide CSR disclosure when they made a costly CSR investment compared to when they made no CSR investment, but that the content of the disclosure focused on the societal benefits of the investment rather than the cost to the company. This suggests that managers believe shareholders gain utility from learning of a positive externality their capital provided but perhaps gain disutility if the specific cost of creating a positive externality is revealed. Further evidence of strategic CSR disclosure is provided by Cho et al. (2010) who examined the optimism and certainty conveyed in firms' CSR disclosures and found that disclosures of poor CSR performers were more optimistic and less certain than good CSR performers.

While many studies have examined the determinants and effects of CSR disclosure volume, there is very little accounting research on CSR disclosure quality. Two exceptions are Plumlee et al. (2015) and Zahller et al. (2015). Plumlee et al. (2015) based their measure of quality on the firm's disclosure conformance to the Global Reporting Initiative's disclosure index. Using this measure, they report that voluntary CSR disclosure quality in the U.S. is positively related to the disclosing firm's future cash flow. Interestingly, this relationship is independent of firms' actual prior CSR performance. However, the authors did not find a relation between CSR disclosure quality and the firm's cost of equity capital. Thus, there appears to be some relation between CSR disclosure quality and firm value, although exactly why this is the case is not yet clear or understood. In an experiment with retail investors, Zahller et al. (2015) shed some light on one way CSR disclosure quality can enhance firm value. Specifically, they report that higher quality disclosures (i.e., disclosures that are quantifiable, comparable, and complete) increased the perceived organizational legitimacy of a company among investors. In

turn, the increased organizational legitimacy made investors less likely to sell the company's stock following a negative exogenous shock.¹⁸

In addition to the Eccles et al. (2014) study discussed earlier, a number of other accounting studies provide evidence that supports the idea that CSR positively contributes to firm value. While Eccles et al. (2014) used stock price and accounting returns (i.e., return on assets and return on equity) as proxies for firm value, these other studies demonstrate additional avenues through which CSR can enhance firm value. For instance, Plumlee et al. (2015) found that better CSR performance produced higher expected future cash flows and Chakravarthy et al. (2014) report that CSR disclosure boosted firms' reputations. CSR has also been found to reduce firms' cost of equity capital (Dhaliwal et al., 2011). One possible explanation for this is that CSR disclosure reduces information asymmetry between firms and market participants. This assertion is supported by Cho et al. (2013), who report that CSR performance information decreased bid-ask spreads for firms with a high proportion of institutional investors. Similarly, Dhaliwal et al. (2012) found that voluntary CSR disclosure reduced analyst forecast error.

Within the accounting CSR literature, qualitative and experimental studies provide useful insight into how CSR disclosure influences retail investors. For example, in a survey of retail investors, Cohen et al. (2011) report that these investors believed CSR information was less relevant for investing decisions than economic and governance information. Yet, there is evidence that CSR information does matter to retail investors, even though it may be perceived as relatively less relevant than other types of information. For instance, in an experimental

¹⁸ Zahller et al. (2015) explain organizational legitimacy as follows: "Organizations seek to establish congruence between the social value associated with or implied by their activities and the norms of acceptable behavior in the larger social system of which they are a part....When an actual or potential disparity exists between the two value systems, there will exist a threat to organizational legitimacy. These threats take the form of legal, economic, or other social sanctions." (Zahller et al., 2015, p. 12).

market, Martin and Moser (2014) report that retail investors were willing to pay a premium for ownership in a company that disclosed its CSR activities compared to a company that did not. One possible moderator to investors' positive stock price response to CSR may be the strategic link between a CSR activity and the firm's operations. That is, Cheng et al. (2015) report that retail investors valued CSR, but only when it was linked to a firm's operational strategy. Relatedly, Wang and Tuttle (2014) found that retail investors used CSR as a signal about management credibility which positively influenced the firm's financial disclosure credibility and the stock price investors were willing to pay for the company. However, the results of an experiment by Elliott et al. (2013) suggests that a positive link between CSR and stock price should be interpreted with caution. This is because retail investors' reaction to CSR might be unintentional. Specifically, Elliott et al. (2013) report that retail investors' positive stock-price reaction to CSR was affect-driven and disappeared when the source of the positive affect was made salient.

2.4 CSR Reporting Models

Because CSR reporting is a relatively new phenomenon for managers, many of them rely on CSR reporting models to help guide the construction of their CSR disclosures. These models have been developed in the absence of a comprehensive CSR reporting model from regulators (KPMG et al., 2013), making the majority of today's CSR disclosures voluntary. Two of the primary functions of these models are to help managers identify what CSR information is relevant for disclosure and to guide managers' preparation and presentation of their CSR disclosures, thereby providing credibility and rigor to the CSR reporting process (Ionnaou and Serafeim, 2012; KPMG et al., 2013). However, these models differ in many of their specific disclosure prescriptions.

Two of the key differences among these models are the stakeholder audience to whom the CSR disclosures are directed and the report where the disclosures will be located. For example, with respect to audience, some models recommend that CSR disclosures be prepared with consideration for *all stakeholders*, whereas other models suggest CSR disclosures be directed to *capital providers*. With respect to disclosure location, some models recommend firms prepare a stand-alone *Sustainability Report* whereas the others recommend firms disclose their CSR activities in a financial report such as the *Management Discussion & Analysis* section of the 10-K. A survey of current disclosure practice reflects these divergent disclosure prescriptions. For example, while a large proportion of firms disclose in a separate sustainability report (Ballou et al., 2012), a growing number of firms are also disclosing CSR information in the annual report.¹⁹ Specifically, KPMG (2013) states that 51% of reporting companies around the globe disclose CSR information in their annual report, which is up from 9% in 2008. In addition, the Investor Responsibility Research Institute and the Sustainable Investments Institute indicate that 499 of the S&P 500 companies currently make some form of CSR disclosure in a financial filing (IRRC, 2013).

In addition to the variation of CSR disclosure practices discussed above, a general concern exists about the lack of comparability and consistency for CSR information across firms and over time (KPMG et al., 2013). One proposed solution to this issue is greater disclosure standardization via a mandatory reporting model, and this approach is receiving increasing support among stakeholders, academics, government officials, and governing bodies (Social Investment Forum, 2009; United Nations, 2012; KPMG et al., 2013; Sulkowski and Waddock,

¹⁹ Holder-Webb et al. (2009) report a negative correlation between CSR disclosure in a mandatory filing (like the MD&A) and firm size, suggesting that smaller firms are more likely to issue CSR disclosures in the MD&A than large firms.

2014; Hales, 2015). It is also being embraced by some standard setters and regulators who are expressing a desire to harmonize the various CSR reporting models and disclosure requirements (KPMG et al., 2013). Even as this notion of CSR disclosure standardization gains additional support, there is a paucity of research to inform regulators and standard setters about how different CSR reporting audiences and locations affect firm behavior and what the implications might be for stakeholders.

2.5 The Manager's Dilemma

In addition to capital providers, other stakeholders (including activists) can also motivate firms to engage in CSR. However, these stakeholders' demands may or may not be associated with CSR activities that translate into firm value (Moser and Martin, 2012). For example, a variety of stakeholder groups would like certain energy firms to install smokestack scrubbers to reduce the pollution they emit into the atmosphere, but this is a costly venture. In these kinds of situations, CSR introduces a new type of complexity into the principal-agent setting (Carroll, 1991; Moser and Martin, 2012; Hales, 2015). One of the reasons for this is because, in addition to meeting the needs of capital providers by maximizing financial benefits, managers now increasingly consider meeting the needs of additional stakeholder groups (e.g., communities, customers, etc.) for whom social benefits may loom larger than financial benefits. In this setting, managers are often faced with situations where the financial and social objectives of an investment conflict, requiring managers to make tradeoffs between the interests of various stakeholder constituencies (Moser and Martin, 2012; Huang and Watson, 2015).²⁰ For example,

²⁰ Managers clearly have economic motives to consider capital providers when making capital allocation decisions, but as discussed above, their motivation to consider other stakeholders may be economic and non-economic. Economically, managers who attend to other stakeholders' interests may do so to improve the firm's public image, to manage firm risk, to reduce production costs, to recruit and retain employees, to stave off unionization attempts, to attract customers, to prevent consumer boycotts, and to reduce the threat of regulatory intervention (Sprinkle and Maines, 2010; Kitzmueller and Shimshack, 2012). Alternatively, one non-economic motive is that managers may

when an investment offers a high social benefit but a low financial return, a manager must weigh the cost of the investment to capital providers against the benefit to other stakeholder groups. It is this setting of conflicting financial and social performance objectives that is of interest in my study.

believe that acting in non-financial stakeholders' interests is simply the right thing to do (Bénabou and Tirole, 2010; Sprinkle and Maines, 2010).

CHAPTER 3

HYPOTHESES DEVELOPMENT

3.1 Accountability

Accountability is a pervasive feature of the natural decision-environment (Tetlock, 1985; Buchman et al., 1996). This is because it is widely accepted that individuals are autonomous (Bandura, 1977). That is, individuals are agents for their decisions and actions (Heider, 1944) and therefore it is normative for society to hold individuals accountable for their decisions (Tetlock, 1992). Consequently, accountability constitutes a crucial link between individual decision-makers and the society in which they operate (Tetlock, 1985).

Individuals feel accountable when they anticipate they may be evaluated by a salient audience for their actions or decisions and that this evaluation may potentially result in a reward or punishment (Lerner and Tetlock, 1999). It is important to note that there only need be a non-zero probability of an evaluation to induce accountability. That is, some probability of evaluation greater than 0% appears to be sufficient (Tan, 1995; Tan and Kao, 1999). Another condition to note is that the evaluation by a salient audience can take many different forms. For instance, prior experimental research on accountability has successfully operationalized an evaluation as a simple third-party observation, a formal review by a peer or a superior, or a requirement for individuals to justify their behavior or decision(s) to a peer or superior (Lerner and Tetlock, 1999).²¹

²¹ Accounting studies on accountability have operationalized an evaluation as the pressure to justify one's actions or decisions to others (Emby and Gibbins, 1988; Ashton, 1990; Johnson and Kaplan, 1991; Kennedy, 1993; Kennedy, 1995; Glover, 1997; Hoffman and Patton, 1997; Asare et al., 2000; DeZoort et al., 2006), a third-party review (Lord, 1992; Koonce et al., 1995; Tan, 1995; Tan and Kao, 1999), and third-party feedback (Ashton, 1990; Cloyd, 1997; DeZoort et al., 2006).

The rewards or punishments associated with accountability that can be administered to decision-makers can vary widely. Tetlock (1985, 1992) identifies specific types of reward/punishment that are economically- or psychologically-based. One pertains to wealth and power. Specifically, the evaluating audience may control economic resources that they can bestow upon or withhold/revoke from the decision-maker. For instance, the audience may have financial or other assets the decision-maker desires. The audience may also be able to advance the position of the decision-maker within an organization and grant her rights or authority she does not currently possess. Individuals' desire for wealth and power is steeped in a long tradition of economics and is widely accepted. Thus, granting wealth and power is an economic form of reward and punishment and withholding or rescinding them can be construed as an economic punishment.

Another form of reward or punishment identified by Tetlock (1985, 1992) relates to the decision-maker's social-image.²² Humans are psychologically motivated to enhance their social-image, and the approval (disapproval) of others has a strong positive (negative) influence on that (Baumeister, 1982, Leary and Kowalski, 1990).²³ For example, with respect to social-image, prior psychology studies report that charitable donations and helping behavior are higher when they are visible to society (Satow, 1975; Gottlieb and Carver, 1980). As another example, conformity to popular opinion, which is one way to gain social approval, is greater in public settings than in private settings (Deutsch and Gerard, 1955). In addition, individuals tend to be more likely to deflect blame for a failure to external sources rather than accept the blame when

²² Consistent with Baumeister (1982), the social contingency model also posits that the desire to obtain and maintain a positive self-image is a third type of reward or punishment that can motivate different coping behaviors in response to accountability pressures.

²³ Tetlock (1985) indicates the idea that social image can alter behavior is related to research in psychology on ingratiation, conformity, and strategic attitude shifts.

the failure is public rather than private (Weary, 1980). Taken together, these examples and a number of others (see Baumeister, 1982 for a review), provide support for the approval (disapproval) of others being an influential psychologically-based reward/punishment for decision-makers. Accordingly, it is common for individuals to seek out the approval of others or, at a minimum, avoid their disapproval.

In summary, because individuals are generally wealth-maximizers and status-seekers, the threat of reward or punishment from an evaluating audience plays a very important role in decision-making as it can constrain individuals' actions and decisions (Tetlock, 1985). Based on this notion of accountability, I next review the accountability literature and elaborate on how accountability can specifically influence individuals' decisions and actions.

3.2 The Social Contingency Model

The social contingency model of judgment and choice (Tetlock, 1985, 1992) provides a theoretical basis to predict how individuals' decisions are influenced by accountability. This model outlines how decision-makers cope when faced with accountability pressures in a variety of different settings. For instance, it explores how a decision-maker copes with accountability pressures that arise both before she makes a decision and afterwards.²⁴ It also discusses coping when a decision-maker knows or does not know who her evaluating audience is or what the preferences of her audience are.²⁵

²⁴ Predecisional accountability occurs when individuals know they will be evaluated by a salient audience with the potential for reward or punishment *before* they make their decision or act, whereas postdecisional accountability is when individuals are told a salient audience will evaluate their decisions and actions *after* those decisions have already been made or those actions have already been taken (see Lerner and Tetlock, 1999, for a review). In the case of postdecisional accountability, the social contingency model predicts individuals will engage in defensive bolstering (Lerner and Tetlock, 1999). Specifically, they become more entrenched in and rigorously defend their prior decision or action (Tetlock et al., 1989; Tetlock and Lerner, 1999). As this type of accountability is not specifically germane to my study, I do not discuss it further.

²⁵ The accounting setting I examine is one in which a manager can reasonably ascertain the preferences of her audience. If the audience's preferences are unknown or not reasonably ascertained, the social contingency model suggests the decision-maker will increase her effort and consider more information and a more balanced set of

The specific setting of interest to my study is predecisional accountability to a known audience. That is, *before* making a decision, a decision-maker knows she will be evaluated by an audience and she also knows who that audience is. Importantly, because the audience is known, the decision-maker can either know or reasonably anticipate what the audience's preference is. In this setting, the social contingency model predicts that when a decision-maker is accountable for her decision, she will seek to make the most defensible decision. That is, she will seek to make the decision that she can best justify to her audience and that is likely to maximize the probability of reward or minimize the probability of punishment from her audience. Intuitively, the decision that her audience will be most pleased with is one that is consistent with the audience's preference. Consequently, the social contingency model predicts that a decision-maker will be heavily influenced by what she perceives her audience's preference to be, even to the point that she may adopt the audience's preference as her own and act consistently with that preference.²⁶ Tetlock terms this behavior as the acceptability heuristic.

In addition to maximizing (minimizing) the probability of gaining the audience's approval (disapproval), another feature of the acceptability heuristic for the decision-maker is that it simplifies her decision and minimizes the cognitive effort she needs to exert to arrive at a decision. That is, rather than gathering and evaluating multiple pieces of information to make a decision, the decision-maker can shortcut this process by simply identifying and adopting the preference of her audience. This effort-minimization approach is consistent with cognitive

information to arrive at her decision (see Tetlock, 1983, 1985, 1992; Tetlock et al., 1989; Lerner and Tetlock, 1999; Tetlock and Lerner, 1999). These results have been supported by a number of accounting studies (e.g., Kennedy, 1993; Koonce et al., 1995; Tan, 1995; Cloyd, 1997; Asare et al., 2000).

²⁶ The accountability literature examines whether adopting the audience's preference is a temporary, impression management strategy, or a more permanent shift as a result of fundamental changes to the decision-maker's cognitive assessment. This literature is inconclusive, providing evidence of both, conditional upon a number of moderators (see Lerner and Tetlock, 1999 for a review). However, for the purpose of this study, the critical factor is that the audience does have an influence on a decision-maker at the time the decision is being made, regardless of the duration of that influence subsequent to the decision.

models in the psychology literature (see Fiske and Taylor, 1991; Chaiken and Trope, 1999; Kruglanski and Gigerenzer, 2011; Evans and Stanovich, 2013) which suggest that human beings, in many settings, tend to behave like cognitive misers. That is, individuals seek to conserve cognitive resources when making decisions and expend those resources only as necessary (e.g., when a more efficient cognitive process does not yield a viable solution). As a result, many of the decisions humans make tend to be automatic, fast, and nonconscious.

So in summary, when individuals feel accountable to others for their decisions before making that decision, the social contingency model suggests that they will be motivated to gain the approval of their audience. One way to do this is by adopting the audience's preference as their own. Thus, this approach becomes a relatively cognitively simple way of making a defensible decision.

Prior research in both psychology (Cialdini et al., 1973; Tetlock, 1983; Tetlock et al., 1989; Klimoski and Inks, 1990) and accounting (Peecher, 1996; Buchman et al., 1996; Hoffman and Patton, 1997; Turner, 2001; DeZoort et al., 2006) provide evidence consistent with this decision-making behavior. For instance, Tetlock (1983) asked participants in his experiment to provide their views on various controversial social issues like capital punishment or national defense spending. In this study, Tetlock manipulated whether participants believed that their views would be confidential or whether they would be revealed to an audience. Further, if the views were revealed to an audience, participants expected to have to justify their views to the audience, which they were told were liberal, conservative or unknown. In the two conditions in which the audience's views were stated to be liberal and conservative, Tetlock reports that the positions participants took were biased in the same direction of their audience's view. That is, participants who expected to justify their beliefs to a liberal audience took a more liberal position

while participants who expected to justify their beliefs to a conservative audience took a more conservative position. These results were later replicated by Tetlock et al. (1989).

The vast majority of the accountability studies in accounting have been conducted in experimental auditing settings where auditor-participants are placed in a scenario in which they perform a specific auditing task. Accountable auditor participants were typically told that they would be required to justify their work to one or more senior auditors or that their work would be evaluated by a supervising auditor. Consistent with the social contingency model, auditor participants could reasonably anticipate that their supervisors preferred more conservative judgments which incentivized them to make more conservative judgments (Hoffman and Patton, 1997). Consequently, these studies report that, compared to when auditor participants were not held accountable for their judgments, accountable auditors made more conservative assessments of fraud risk (Hoffman and Patton, 1997) and materiality (DeZoort et al., 2006). They also issued more qualified audit opinions (Lord, 1992; Buchman et al., 1996). For instance, Buchman et al. (1996) provided auditors with information about a potential lawsuit and asked them how they believe the client should report the lawsuit and what audit opinion they would recommend. The authors manipulated whether auditors anticipated meeting with either the client's vice president or the audit partner (who is known to be conservative) to review their decisions. They found that auditors with experience in this type of decision-setting were significantly influenced by their audience. Specifically, experienced auditors who met with the audit partner were more likely to recommend a qualified audit opinion while those who met with the client were more likely to recommend an unqualified audit opinion.

In another insightful study that did not directly manipulate accountability, Gaynor et al. (2006) recruited experienced corporate directors as experimental participants and looked at

whether an audit committee's decision to hire its auditor for a non-audit service might be influenced by the disclosure of this action to investors. The investors in this study, which were hypothetical, were the evaluating audience with an implicit ability to reward or punish the directors based on their decision. The directors were told that hiring the auditor to perform the non-audit services would improve audit quality, even though it may appear to impair auditor independence. Consistent with social contingency theory, directors acted as if they believed investors would prefer the appearance of auditor independence over audit quality and were less willing to hire the auditor when disclosure of the non-audit services was required compared to when it was not required. Thus, it seems that the mere imagined anticipation of being held accountable for a decision can influence highly-experienced professionals even to the point of deterring them from making what is arguably a sound business decision.²⁷

While the social contingency model and prior accountability research provide clear predictions for decision-making settings in which the preference of an audience is perceived to uniformly favor one position over another, predictions for when an audience has a dispersion of preferences have been given less attention and are therefore less clear. By dispersion of preferences, I mean that a large proportion of the audience has one preference and another large proportion of the audience has a conflicting preference. One study, Green et al. (2000), examined this setting of disperse audience preferences. They provide evidence that, because a defensible decision is ambiguous, decision makers employ strategies to avoid making a decision such as

²⁷ Similarly, Adelberg and Batson (1978) report the results of an experiment that examined the efficiency of financial aid distribution to applicants when the distributor had to report to the financial aid office or to the applicants. Thus, the study manipulates whether the distributor is accountable to the aid office or to the applicants. Adelberg and Batson find that, in the setting where the available aid was limited such that it was only effective if it went to some but not all of the applicants, the distributors allocated the aid efficiently when they were accountable to the aid office but not when they are accountable to the applicants. That is, distributors allocated aid to some applicants and not others when accountable to the aid office so that at least some applicants could benefit. However, distributors allocated aid to all applicants when they were accountable to the applicants which essentially rendered the aid ineffective for all applicants.

ignoring the decision, delegating it to another individual, or postponing the decision. However, there is little research evidence of what decision-makers are likely to do when a decision must be made. That is, in many settings, delaying or deflecting a decision is simply not an option and decision-makers must act. Tetlock (1992) speculates that, in a setting of disperse audience preferences, the decision-maker will likely increase their cognitive effort and engage in additional information processing (p. 347). This response is consistent with both dual-process theories in psychology (Chaiken and Trope, 1999) and with research on accountability increasing a decision-maker's effort when the audience preference is unknown (see Footnote 25 above). Thus, if anything, it seems that in settings when a decision-maker is accountable to an audience with disperse and conflicting preferences, she may be inclined to expend more effort, search for more information, and consider a broader information set compared to when the audience's preference uniformly favors a single position.

3.3 CSR Reporting Models and Managers' Decisions

In today's business setting, managers are faced with a wide range of accountability pressures from various stakeholder groups, and I expect that these accountability pressures will influence managers' behavior (Pondeville et al., 2013; Rodrigue et al., 2013). Consistent with the research cited above and as outlined in Figure 1, I propose that the disclosure audience and location made salient by a CSR reporting model will jointly influence how accountable managers feel for financial and social performance which will affect their capital allocations. Specifically, I posit that managers will consider the preference of the disclosure audience in an effort to identify the most defensible decision. If the audience's preference uniformly favors financial or social benefits, I predict managers will make a capital allocation consistent with that preference. However, if some of the audience prefers financial benefits and some of the audience prefers

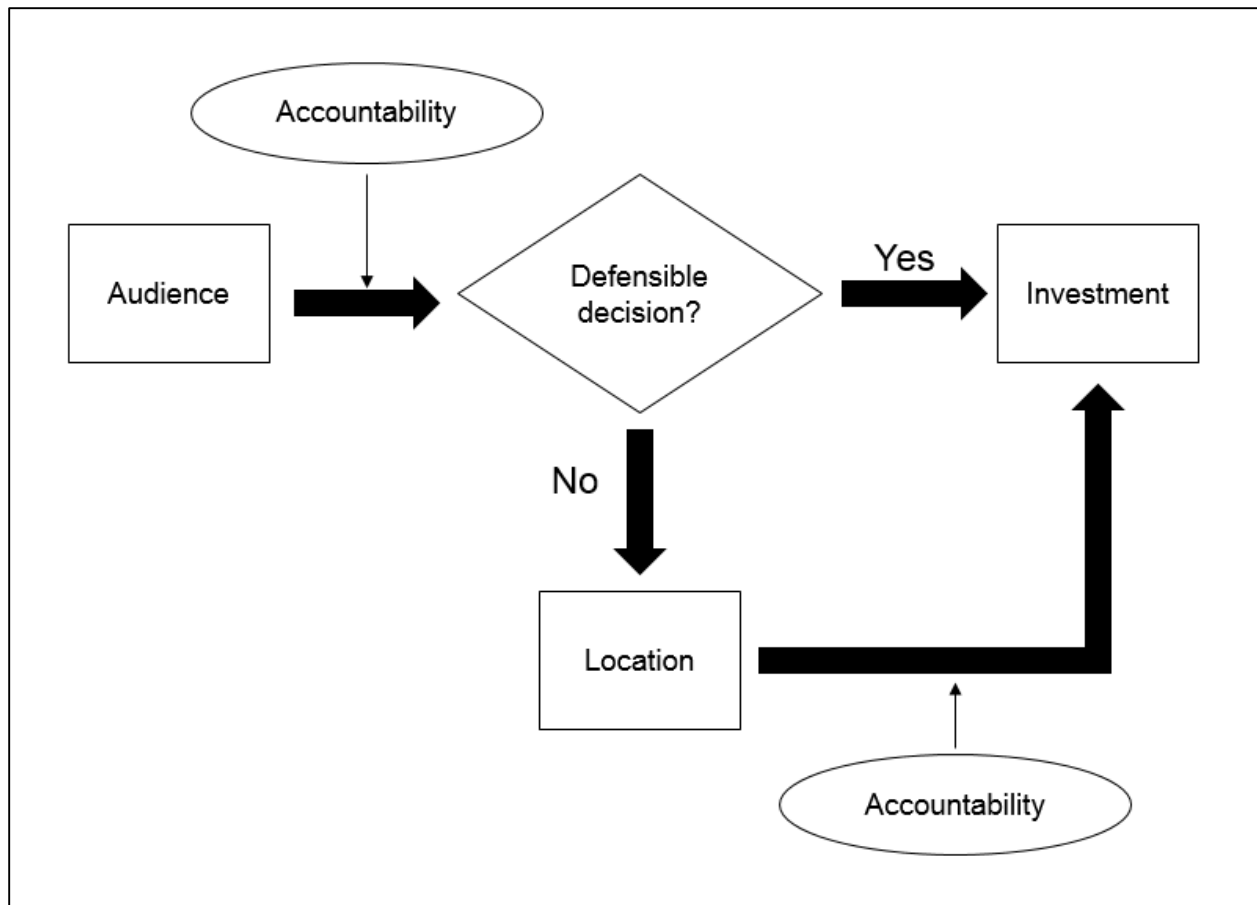


Figure 1: Accountability Predictions

social benefits, I predict managers will then consider the disclosure location to identify the most defensible decision. Thus, when the disclosure audience is exclusively capital providers, managers will be more likely to invest in projects that favor financial benefits over social benefits because they believe capital providers prefer financial performance to social performance. However, when the audience has disperse and conflicting preferences between financial and social benefits, as is likely the case when the disclosure audience includes both capital providers and other stakeholders, managers will be more likely to invest in projects that favor financial benefits (social benefits) when disclosing in MD&A (Sustainability Report). This is because I expect managers will perceive that the content of the overall MD&A is more

financially oriented and will more likely associate it with a capital-provider audience compared to a Sustainability Report. By comparison, I expect managers will perceive that a Sustainability Report is more socially oriented and will more likely associate it with a broad stakeholder audience relative to MD&A.²⁸ Consequently, managers disclosing to all stakeholders in MD&A will feel more accountable for financial performance and managers disclosing in a Sustainability Report will feel more accountable for social performance.

Based on the above, I expect disclosure audience and location to jointly influence managers' capital allocations. Specifically, I expect managers' capital allocations to be weighted toward financial benefits when they direct their CSR disclosures to only capital providers and/or when they disclose their CSR information in MD&A. In contrast, I expect managers disclosing to all stakeholders in a Sustainability Report to weight their capital allocations toward social benefits. Accordingly, my first hypothesis, which is illustrated in Panel A of Figure 2, is as follows:

H1: Given the choice between financial and social benefits, managers allocate more capital to activities that provide superior financial benefits when disclosing to just capital providers and/or when disclosing in MD&A compared to when disclosures are directed to all stakeholders in a Sustainability Report.

I also expect differences in managers' capital allocations to be driven by how accountable they feel for financial and social performance. Therefore, my second hypothesis is:

H2: The joint influence of the disclosure audience and location is mediated by how accountable managers feel for financial and social performance.

²⁸ Evidence supporting this expectation is discussed in Section 6.3 below.

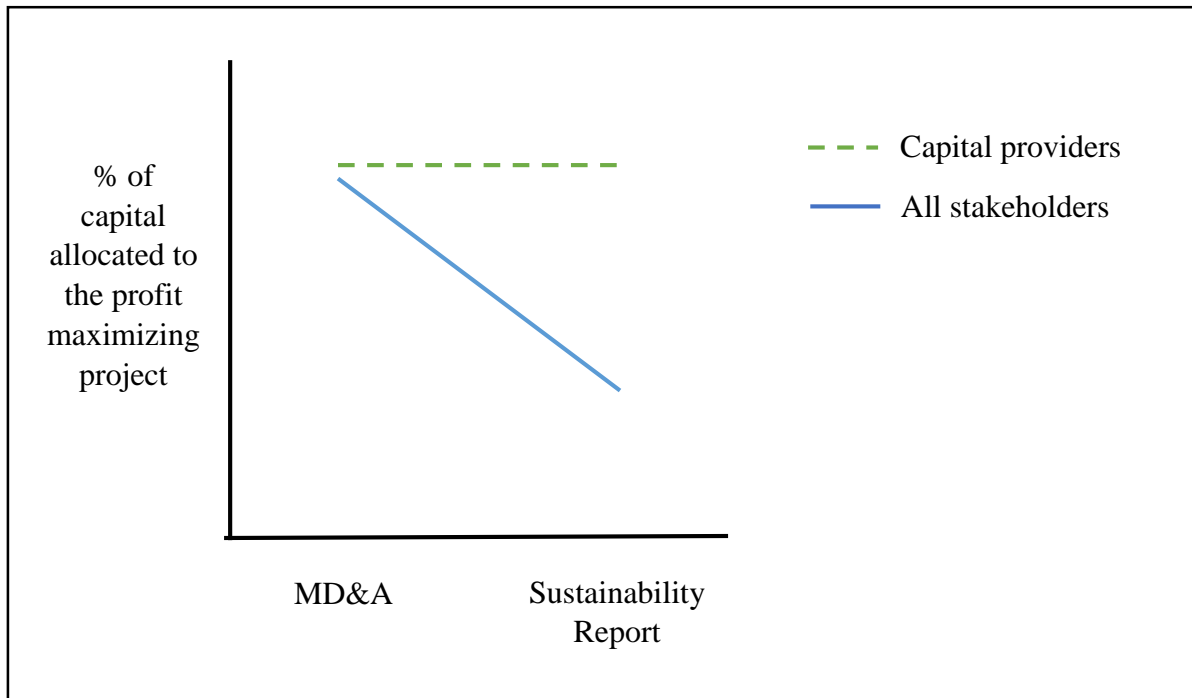


Figure 2 Panel A: H1 Prediction

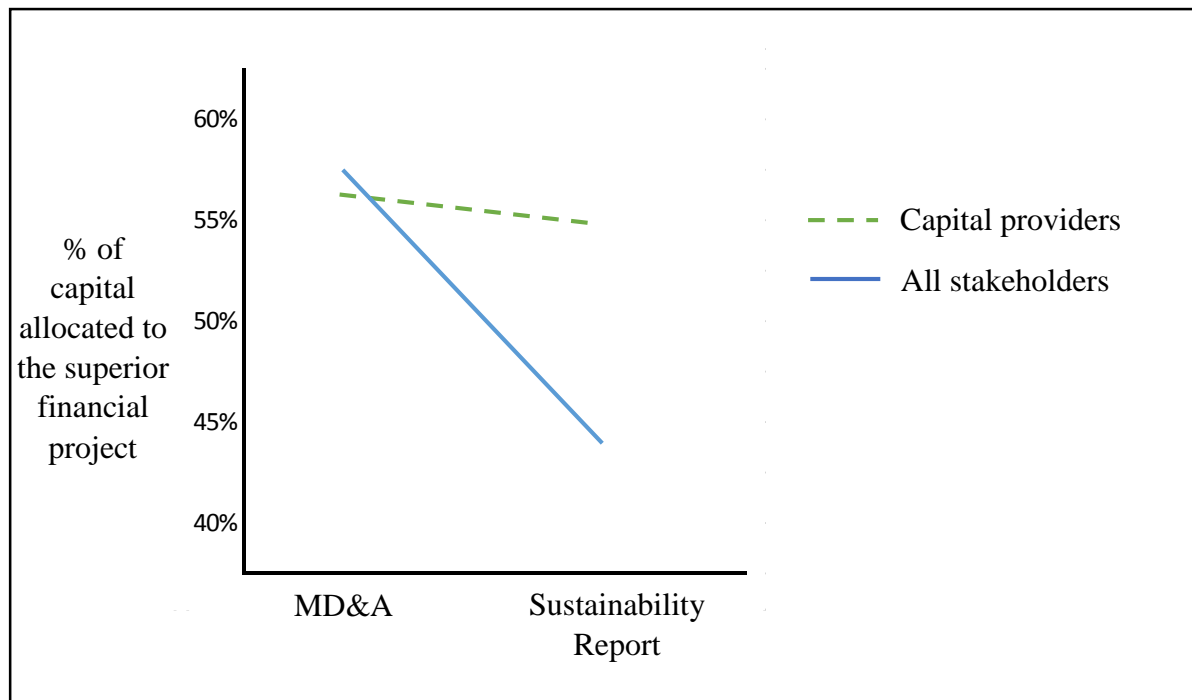


Figure 2 Panel B: H1 Result

CHAPTER 4

METHODOLOGY

4.1 Experimental Design

To test my hypotheses, I conduct a 2x2 between-participant experiment by manipulating the CSR disclosure audience and location. I manipulate audience by telling participants that their CSR disclosures will be directed to investors and lenders (“capital providers”) or to investors, lenders, communities, governments, non-governmental organizations, customers, and suppliers (“all stakeholders”).²⁹ I manipulate location by telling participants that their CSR disclosures will primarily be communicated in the Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in the annual report or in a Sustainability Report.³⁰

To help ensure that there are no differences in participants’ understanding of the stakeholder groups they disclose to and the report they disclose in, participants receive a brief description of each stakeholder group they will disclose to and a summary of the general purpose of the report where their CSR disclosures will be made. The description for MD&A is taken directly from SEC Interpretation 33-8350: Commission Guidance Regarding Management’s

²⁹ While not exhaustive, the list of stakeholders in the “all stakeholders” condition includes many of the most common stakeholder groups representing a wide range of stakeholder interests and is reflective of most of the stakeholders identified by public companies in their CSR disclosures. For example, ExxonMobil’s 2013 Corporate Citizenship Report lists governments, shareholders, suppliers, customers, employees, communities, NGO’s, and academic institutions as their stakeholders. Similarly, in its 2014 Sustainability Report Samsung lists their stakeholders as shareholders, suppliers, local communities, government, NGO’s, employees, customers, and media.

³⁰ Disclosure audience and location may not be orthogonal variables. That is, when considering the disclosure location, participants could consider the stakeholders who view the report. However, I chose to manipulate these variables because the primary purpose of this study is to provide information about the implications of differences among CSR reporting models, and audience and location represent two of the key differences among existing reporting models.

Discussion and Analysis of Financial Condition and Results of Operations.³¹ This description states that the general purposes of the MD&A section are to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management; to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance. The description of the general purpose of a sustainability report is based on GRI's explanation that sustainability reports report a company's economic, environmental, and social impacts; present a company's values and governance model, and demonstrate the link between its strategy and its commitment to a sustainable global economy; and help companies measure, understand and communicate their economic, environmental, and social governance performance.

I use two dependent variables to test my hypotheses. My dependent variable for H1 is participants' capital allocations to a CSR project. My dependent variable for H2 is how accountable participants feel for financial and social performance. Each of these measures is discussed in more detail below.

4.2 Experimental Procedure

The experiment consisted of a paper-and-pencil task and proceeded in four stages. In the first stage, participants were given an informed consent letter, instructions for the experiment, and three numbered envelopes. Each participant read the informed consent letter and reviewed instructions for the experiment. In these instructions, participants were asked to assume the role of CEO of XYZ, a publicly-traded U.S. company. They were informed that their task would

³¹ SEC Interpretation 33-8350 is available at <http://www.sec.gov/rules/interp/33-8350.htm>. The GRI's explanation of the purpose of a Sustainability Report is available on its website at <https://www.globalreporting.org/>.

involve evaluating information about potential CSR activities, making a decision, and explaining their decision. (See Appendix A.)

In the second stage (see Appendices B and C), participants opened, reviewed, and completed the contents of Envelope 1 which contained background information about XYZ and three years of selected historical financial information.³² This three year period was one of year-to-year positive growth, and participants were told that XYZ's growth rate was consistent with the median growth rate among firms in XYZ's industry. Holding XYZ's financial performance constant across conditions allows me to control for the positive correlation between financial performance and CSR activities documented by prior research (e.g., Schmitz and Schrader, 2013; Lys et al., 2014). Next, participants received information about their role as CEO, which included selecting and funding CSR activities as well as overseeing XYZ's CSR disclosures. Participants were then informed about the reporting model that they used. Specifically, they were told which stakeholders their disclosures would be directed to and where these disclosures would primarily be located. Subsequently, participants were given specific information about two potential CSR activities they would evaluate—A and B—both of which are expected to reduce the volume of water XYZ uses.^{33,34} Both A and B are expected to produce positive financial benefits and positive social benefits (via reduced water use). However, the expected benefits for A exceed XYZ's hurdle rate but fall short of XYZ's annual water reduction target. By

³² XYZ and its selected financial information are based on a real U.S. public company, InvenSense, Inc. However, the company name and other identifying information was changed to ensure that any familiarity with InvenSense does not affect participant responses.

³³ In the experimental materials (provided in the Appendices), these two projects were referred to as Activity A and Activity B.

³⁴ According to Corporate Knights Capital (2014), water usage is one of seven basic CSR indicators. In addition, over 80 (approximately 20%) listed companies in the information technology sector—the same sector as InvenSense, Inc.—provided CSR disclosures about their water use in 2012 (Corporate Knights Capital, 2014). Examples of other public companies that disclose water use information include Sony, Coca Cola, Ford, Walmart, Darden Restaurants, and ExxonMobil.

comparison, the expected benefits of B exceed XYZ's annual water reduction target but fall short of XYZ's hurdle rate. Next, participants were told that A and B could be undertaken simultaneously or independently and were asked to fully allocate a fixed but unknown amount of capital between them. The percentage of capital participants allocated to project A is the primary dependent variable in my experiment.³⁵ After making their allocation, participants were asked to provide an explanation of their allocation decision and its benefits for inclusion in the CSR disclosures. To complete the second stage, participants placed their materials back in Envelope 1.

In the third stage of the experiment participants removed the contents of Envelope 2 and completed the manipulation check questions. After they placed their responses to the manipulation check questions back in Envelope 2, participants proceeded to stage four of the experiment. In the fourth stage, participants answered questions from Envelope 3 pertaining to their allocation decision, accountability, and demographics. After they answered the demographic questions, participants delivered all of their materials to the experimenter and received their compensation.

4.3 Participants

I recruit 109 individuals in a MBA class to participate in my study. Using MBA participants as proxies for managers is consistent with prior accounting research (Lipe and Salterio, 2000; Banker et al., 2004; Libby et al., 2004; Kelly, 2007; Jackson, 2008; Beaudoin et al., 2013; Rennekamp et al., 2015). Demographic information for my participants is summarized in Table 1. Of my 109 participants, 73.39% are male. On average, participants are 29.58 years old (S.D. = 4.42 years), have 6.20 years of general work experience (S.D. = 4.19), 2.25 years of management experience (S.D. = 2.91), and have taken 4.46 accounting and finance courses (S.D. = 4.16). Of

³⁵ By design, participants make a zero-sum allocation between the two projects. As a result, statistical are identical using capital allocations to either CSR project.

Table 1: Participant Demographic Information ¹

1	2	3	4	5	6
	All Conditions n=109	Capital Providers n=55	All Stakeholders n=54	MD&A n=55	Sustainability Report n=54
Male (%)	73.39%	76.36%	70.37%	70.91%	75.93%
Age (years) ²	29.58	28.94	30.22	29.47	29.70
Work Experience (years)	6.20	5.83	6.57	6.20	6.20
Management Experience (years)	2.25	1.75	2.77	2.20	2.30
Accounting & Finance Courses	4.46	4.96	3.94	4.42	4.50
Democrat (%)	35.19%	29.63%	40.74%	34.55%	35.85%
Republican (%)	29.63%	33.33%	25.93%	32.73%	26.42%
Independent (%)	26.85%	27.78%	25.93%	25.45%	28.30%
Other (%) ²	8.33%	9.26%	7.40%	7.27%	9.43%

1. Demographic information for all 109 participants is presented in the All Conditions column. Demographic information for the Capital Providers, All Stakeholders, MD&A, and Sustainability Report conditions are provided in the columns bearing the same name. The figures reported in each row are as follows: the Male row indicates the percentage of male participants; the Age row reports participants age in years; the Work Experience row states participants' years of work experience; the Management Experience row indicates the years of management work experience; the Accounting & Finance Courses row reports the number of undergraduate and graduate level accounting and finance courses participants have taken; and the Democrat, Republican, Independent, and Other row provides the percentage of participants who identify with each respective political party.
2. One participant in the Capital Providers/Sustainability Report condition did not provide their age. A different participant in the same condition did not provide their political affiliation.

the 108 participants who provided information about their political affiliations, 35.19% identified as democrat, 29.63% as republican, 26.85% as independent, and 8.33% as other. With the exception of management experience, there are no significant differences across conditions in the

measured demographic variables (all p-values > 0.10).³⁶ However, when management experience is included as a covariate in the hypotheses tests below, inferences are unchanged.

Each participant received \$10.00 as compensation for completing the study. I do not expect that the absence of financial incentives to allocate capital to a project that maximizes financial performance affects the generalizability of my study. If I had used stronger financial incentives, then I would expect an increase in capital allocations that favored financial benefits across all experimental conditions, making it more difficult to detect differences across my experimental conditions. However, I would still expect the pattern of my predictions to hold.

³⁶ The difference between the average management experience in the Capital Providers condition (1.75 years) and the All Stakeholders condition (2.77 years) is marginally significant ($t = -1.833$, $p = 0.070$, two-tailed).

CHAPTER 5

RESULTS

5.1 Manipulation Check Questions

To determine whether participants attended to the audience manipulation, I ask them to recall the stakeholder groups to which they directed their CSR disclosures. Forty-seven of fifty-five participants (85.45%) disclosing to just capital providers answered this question correctly compared to fifty-two out of fifty-four participants (96.30%) disclosing to all stakeholders. I also ask participants to recall where their CSR disclosures would be made. Forty-eight of fifty-five participants (87.27%) answered this question correctly in the MD&A condition while fifty-one out of fifty-four (94.44%) answered this question correctly in the Sustainability Report condition. Because testing my hypothesis presupposes that participants attend to my manipulations, I exclude the 18 participants who fail to answer either acquisition check question correctly from my analyses, resulting in a sample size of 91 participants. The number of participants excluded do not differ across experimental conditions (all p 's > 0.10) and including these participants produces similar statistical results, except as noted below.

5.2 Hypotheses Tests

Participants make their capital allocations to two projects—A and B—by selecting the percentage of a fixed amount of capital they will allocate to each. Allocations can range from 0% to 100% for each project, and the sum of the percentages allocated to the two projects are required to total 100%. Table 2, Panel A provides the descriptive statistics for participant

Table 2: Participant Capital Allocations**Panel A: Descriptive statistics: Mean and (standard deviation)**

Disclosure audience	Disclosure location		Row Means
	MD&A	Sustainability Report	
Capital Providers	55.82 (32.20) n=22	54.57 (27.92) n=23	55.18 (29.75) n=45
All Stakeholders	57.00 (24.26) n=21	44.60 (27.99) n=25	50.26 (26.81) n=46
Column Means	56.40 (28.27) n=43	49.37 (28.11) n=48	

Panel B: Contrast Coded ANOVA

Source	S.S.	df	M.S.	F-Statistic	<i>p</i> -value
Audience x Location	2271.35	1	2271.35	2.84	0.048*
Residual	51.11	2	25.55	0.03	0.969
Error	69492.93	87	798.77		

Panel C: Simple Main Effects

	<i>df</i>	F-stat	<i>p</i> -value
Effect of location when audience is capital providers	1	0.15	0.882
Effect of location when audience is all stakeholders	1	1.13	0.071*

Table 2 presents descriptive statistics, contrast-coded ANOVA, and simple main effects tests for participants' capital allocations. Participants are asked to allocate a fixed but unspecified amount of capital between two CSR activities: one that provides superior financial benefits but inferior social benefits (project A), and one that provides inferior financial benefits but superior social benefits (project B). Allocations are made to each project as a percentage of the fixed capital, ranging from 0% to 100%. The numbers in Panel A reflect participant allocations to project A. The four cells in my experiment receive the following contrast weights: capital providers/MD&A = +1, capital providers/Sustainability Report = +1, all stakeholders/MD&A = +1, all stakeholders/Sustainability Report = -3. * Indicates a one-tailed *p*-value to reflect my directional predictions. All other *p*-values are two-tailed.

allocations to project A, which is the project that provides high financial benefits but low social benefits. These allocations are depicted in Figure 2, Panel B. H1 predicts an interaction of disclosure audience and location such that participant allocations to project A will be lowest when disclosing to all stakeholders in a Sustainability Report and that allocations to project A will be approximately the same in all other conditions. I test this hypothesis with a contrast-coded analysis of variance (ANOVA) because doing so provides superior statistical power to the traditional ANOVA for testing ordinal interactions while also controlling for Type I error rates (Buckless and Ravenscroft, 1990). The contrast weights I use are as follows: +1 in the capital providers/MD&A condition, +1 in the capital providers/Sustainability Report condition, +1 in the all stakeholders/MD&A condition, and -3 in the all stakeholders/Sustainability Report condition.

The results of the interaction test, as reported in Panel B of Table 2, are consistent with H1 ($p = 0.048$, one-tailed).^{37,38} Additionally, the insignificant residual variation reported in Panel B ($p = 0.969$, two-tailed) suggests that the differences in participants' capital allocations across my experimental conditions are not significantly explained by anything other than the predicted contrast-coded interaction (Keppel and Wickens, 2004, p. 82-83). Tests of simple main effects, reported in Panel C, also provide support for the interaction. Specifically, disclosure location does not appear to influence participants' capital allocations when the audience is capital

³⁷ This interaction remains significant using alternative contrast weights consistent with the allocations of participants disclosing to only capital providers and/or disclosing in the MD&A being higher than the allocations of participants disclosing to all stakeholders in a Sustainability Report.

³⁸ Given my directional hypothesis for the audience x location interaction, I report a one-tailed p-value for this contrast-coded ANOVA test. See McNeil et al. (1996, pp. 137-139) for a discussion of the logic of using one-tailed tests for directional interaction predictions.

providers ($p = 0.882$, two-tailed), but does when the audience is all stakeholders ($p = 0.071$, one-tailed). Taken together, these results provide support for H1.^{39,40}

H2 predicts that the differences in participants' capital allocations will be driven by how accountable they felt for financial and social performance.⁴¹ To determine whether the disclosure audience and location affect how accountable participants felt, I ask four questions following their allocation decision. These questions ask participants to indicate the extent to which they agree with statements suggesting they felt their allocation 1) needed to produce the best financial return possible, 2) needed to produce the best social benefit possible, 3) should be consistent with the preferences of capital providers, and 4) should be consistent with the preferences of non-financial stakeholders. Participants answer each question on an 11-point scale anchored by "Don't agree at all" (0) and "Completely agree" (10). Because participants are required to choose between financial and social performance in my study, I multiply participant responses to the accountability questions about social performance and other stakeholders by negative one so that they range from 0 to -10 to reflect the opposing dimensions to the accountability questions about financial performance and capital providers which are coded from 0 to 10. Means (standard deviations) for responses to these questions are reported in Panel B of Table 3. I next run a factor

³⁹ I replicate these results using Amazon Mechanical Turk workers as participants. After eliminating participants who failed the manipulation check questions (totaling 42% of participants), I detect a significant contrast-coded interaction ($p = 0.002$, one-tailed) after controlling for participants' individual CSR preferences. This significant interaction is supported by a significant simple main effect of location when the disclosure audience includes all stakeholders ($p = 0.021$, one-tailed) but not when the audience is solely capital providers ($p = 0.556$, two-tailed).

⁴⁰ Including participants who incorrectly answer the manipulation check questions also yields a marginally significant contrast coded interaction ($p = 0.053$, one-tailed), an insignificant contrast model residual ($p = 0.830$, two-tailed), and an insignificant simple main effect of location when the disclosure audience is capital providers ($p = 0.704$, two-tailed). However, the simple main effect of location becomes insignificant when the audience is all stakeholders ($p = 0.145$, one-tailed).

⁴¹ As discussed in Section 3.1, the social contingency model predicts that managers will feel accountable when they can potentially be rewarded or punished for their decisions by an evaluating stakeholder audience. Importantly, these rewards or punishments can take many forms, including social and reputational rewards and punishments. Using a vignette, my experiment assumes participants will place themselves in the mindset of managers and anticipate how stakeholders will respond to their decisions. I therefore rely on a reputational reward or punishment via favorable or unfavorable stakeholder reactions to create the perception of managerial accountability.

Table 3: Reported Accountability**Panel A: Accountability Mean and (standard deviation) Factor Score**

	Disclosure location		
Disclosure audience	MD&A	Sustainability Report	Row Means
Capital Providers	-0.26 (1.13) n=22	0.03 (1.03) n=23	-0.11 (1.08) n=45
All Stakeholders	-0.16 (0.95) n=21	0.33 (0.85) n=25	0.11 (0.92) n=46
Column Means	-0.21 (1.03) n=43	0.19 (0.94) n=48	

The descriptive statistics above reflect the factor score from a factor analysis of responses to the four accountability questions described in Panel B below.

Panel B: Participant Accountability Responses

	Capital Providers / MD&A (n = 22)	Capital Providers / Sustainability Report (n = 23)	All Stakeholders / MD&A (n = 21)	All Stakeholders / Sustainability Report (n = 25)
1. Financial return	6.23 (2.56)	5.22 (3.37)	6.67 (2.78)	4.96 (2.30)
2. Social benefit	-4.64 (3.19)	-4.74 (3.06)	-5.33 (3.17)	-6.12 (2.54)
3. Capital providers	6.27 (3.10)	5.91 (2.56)	6.67 (2.58)	5.80 (2.08)
4. Other stakeholders	-4.00 (2.99)	-4.96 (2.77)	-4.86 (2.89)	-5.72 (1.95)

The mean (standard deviation) statistics above reflect participant responses to four questions (reflected in the table rows) in each of my four experimental conditions (reflected in the table columns). All four questions ask participants to indicate the extent to which they agreed with a statement that followed. The statement in the first question was “I felt like my CSR funding decision for project A and project B needed to produce the best financial return possible.” The statement in the second question was “I felt like my CSR funding decision for [project] A and [project] B needed to produce the best environmental benefit possible.” The statement in the third question was “I felt like my CSR funding decision for [project] A and [project] B should be consistent with the preferences of capital providers (i.e., investors and lenders).” The statement in the fourth question was “I felt like my CSR funding decision for [project] A and [project] B should be consistent with the preferences of non-financial stakeholders (i.e., communities, customers, etc.).” Responses to all questions were made on an 11-point scale anchored by “Don’t agree at all” (0) and “Completely agree” (10). Responses to statements 2 and 4 were subsequently multiplied by -1 to convert the scale to range from 0 to -10.

analysis on participant responses to these four questions. Results from this analysis report only one factor with an eigenvalue (2.34) greater than the cutoff value of 1.00. This factor accounts for 58% of the variance in participant responses and all four accountability questions load on this factor in the expected direction. Therefore, I use the score from this factor as my measure of accountability felt by participants. Means (standard deviations) for this score for each of my four experimental conditions are reported in Table 3 Panel A.

To test H2, I conduct a mediation test to determine if participants' capital allocations are driven by accountability. To do this, I create a dummy variable that equals zero if participants are in the capital providers condition and/or in the MD&A condition. The dummy equals one for participants in the all stakeholders/Sustainability Report condition.⁴² I then follow the four-step procedure prescribed by Baron and Kenny (1986) to test the mediation. The independent variable in this procedure is the dummy variable for my experimental conditions representing the interaction of audience and location, the mediator is the measure of accountability derived from the factor analysis described above, and the outcome variable is participants' capital allocations to project A. As depicted in Figure 3, step one and step two indicate that the interaction of audience and location is significantly associated with participants' capital allocations ($p = 0.047$, one-tailed) and accountability ($p = 0.025$, one-tailed), respectively.⁴³ Step three confirms that accountability is associated with participants' allocations ($p < 0.001$, one-tailed). Finally, step

⁴² Creating this variable is consistent with my prediction and finding that participants' capital allocations in the capital-providers condition and/or the MD&A condition are not statistically different from one another but are collectively statistically different from the allocations of participants in the all stakeholders/Sustainability Report condition.

⁴³ To support the dummy variable coding I use to represent the audience x location interaction to test H2, I remove the all stakeholder/Sustainability Report condition from the sample and rerun steps one and two of the mediation test. Doing so tests whether there are any effects of disclosing to capital providers and/or in the MD&A on participant allocations or on the accountability mediator, which I don't expect there to be. Consistent with my expectations, I do not find a significant effect of these independent variables on capital allocations ($p = 0.894$, two-tailed, untabulated) or on the accountability mediator ($p = 0.745$, two-tailed, untabulated).

four indicates that when accountability is controlled for, the effect of the audience-disclosure interaction on participants' allocations becomes insignificant ($p = 0.941$, two-tailed) while accountability remains significant ($p < 0.001$, one-tailed). Thus, step four confirms that accountability fully mediates the effect of the audience x disclosure interaction on participants' allocations, supporting H2.⁴⁴

In summary, I find that when the CSR disclosure audience and location are salient, they jointly influenced how accountable participants feel for financial and social performance which, in turn, affects their capital allocation decisions. That is, my results indicate when the CSR reporting model distances CSR disclosure from capital providers' preferences and a financial reporting setting, manager-participants feel relatively more accountable for social performance compared to financial performance. Consequently, they shift their capital allocations from financial benefits to social benefits.

⁴⁴ I also find evidence that participant allocations in the all-stakeholders condition are influenced by the extent of the financial information in the MD&A and Sustainability Report as well as the stakeholders they believe will view the report (independent of who the disclosure audience is). However, the effect of these potential mediators on capital allocations are subsumed by the accountability mediator.

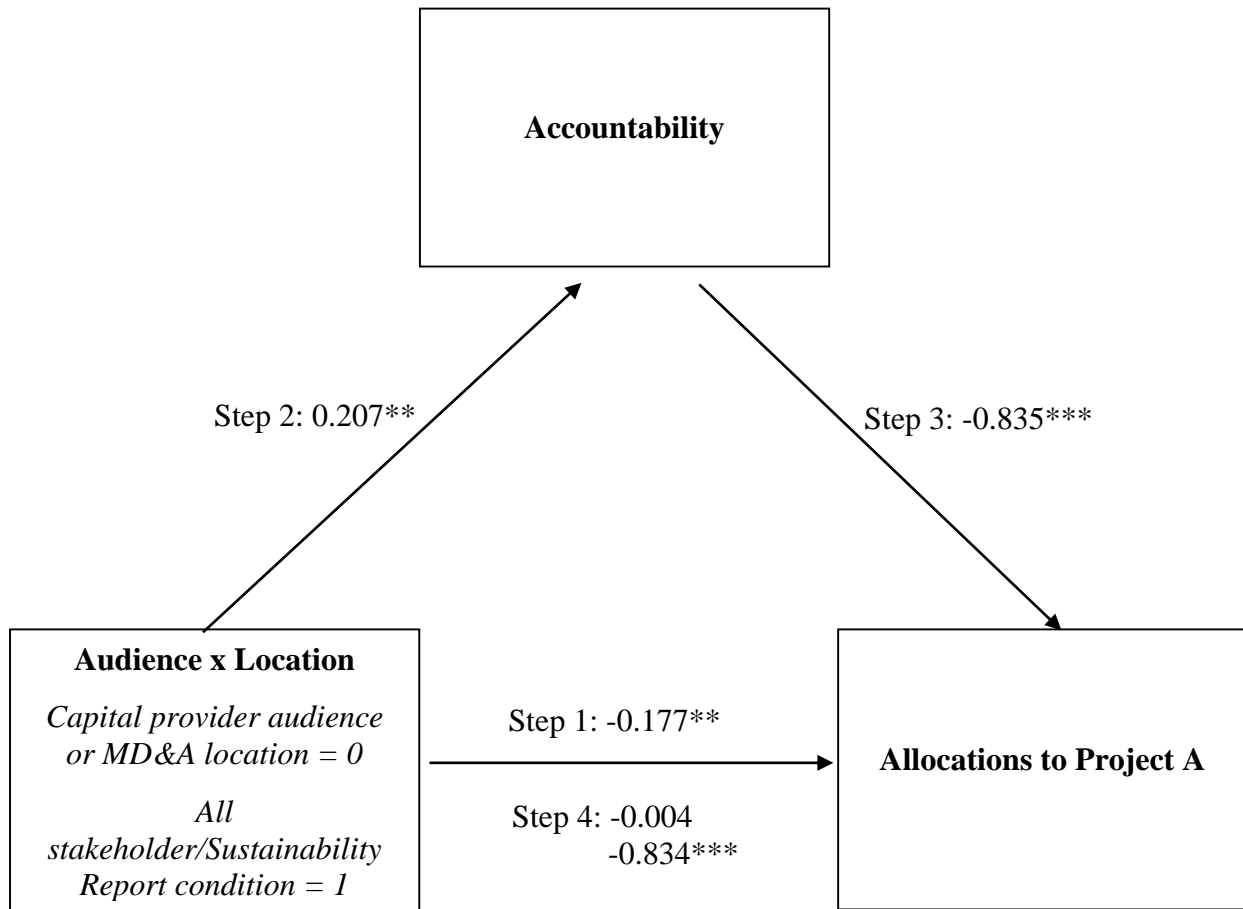


Figure 3: Test of Mediated Moderation. This figure presents the observed standardized coefficients for the four-step mediation procedure prescribed by Baron and Kenny (1986). The Audience x Location independent variable is a dummy variable coded 0 if participants are in the capital provider audience condition and/or in the MD&A location condition or 1 participants are in the all stakeholder/Sustainability Report condition. The mediator variable is the difference score between the felt accountability for financial and social performance reported by participants. The outcome variable is participants' capital allocations to project A. *, **, *** denote one-tailed significance given my directional expectations at the 0.10, 0.05, and 0.01 levels, respectively.

CHAPTER 6

SUPPLEMENTAL ANALYSES

My hypotheses are predicated on a number of assumptions. In the sections that follow, I provide evidence to support these assumptions. Specifically, I address my assumptions regarding participants' perception of stakeholder preferences, participants' beliefs about the uniformity and dispersion of the disclosure audience's preference for financial and social benefits, the relative strength of the influence of disclosure audience and location on participants' capital allocations, and the content and viewership participants associated with the disclosure location. I also address whether individual participant preferences for CSR influenced their capital allocations.

6.1 Participant Perception of Stakeholder Preferences

I assume that participants perceive capital providers prefer financial benefits to social benefits, while, other stakeholders (i.e., non-capital providers) collectively prefer social benefits to financial benefits. To verify that this is the case, I ask a post-experimental question to participants about what preferences for financial benefits compared to social benefits they believe each of seven different stakeholder groups have. These groups include investors, lenders, communities, governments, non-governmental organizations, customers, and suppliers. Specifically, for each stakeholder group, I ask participants to indicate whether they believe that group prefers financial benefits or social benefits on an 11-point scale anchored by "Strongly favor financial benefits" (0) and "Strongly favor environmental benefits" (10), with the mid-point labelled as "Equally favor financial and environmental benefits" (5).

Descriptive statistics for participant responses to this question are reported in Table 4 Panel A. One-sample t-tests reported in Panel B support my prediction that participants perceive

capital providers prefer financial benefits while other stakeholders prefer social benefits. These t-tests analyze whether the mean response for capital providers and other stakeholders suggests a perceived preference for financial and social benefits, as measured by the difference from the mid-point of the response scale. The differences for both capital providers and other stakeholders are highly significant. That is, participants believe the collective preference of capital providers (i.e., investors and lenders) significantly favors financial benefits ($p < 0.001$, one-tailed) while the collective preference of other stakeholders (i.e., communities, governments, non-governmental organizations, customers, and suppliers) significantly favors social benefits ($p < 0.001$, one-tailed).⁴⁵

Next, I directly examine the variance in participants' beliefs about their stakeholder audience's preference for financial and social benefits between disclosure audience conditions. I expect that participants believe a capital provider audience has a uniform preference for financial benefits and that an audience that includes all stakeholders has divergent preferences for both financial and social benefits. To calculate perceived preference divergence, in the capital providers (all stakeholders) condition I average each participant's response reported in Table 4 Panel A for investors and lenders (investors, lenders, communities, governments, NGOs, customers and suppliers). Next, I calculate the absolute difference between this average and the responses for each individual stakeholder group for every participant and then calculate an overall mean difference score for each participant. Finally, I calculate an overall mean (s.d.) difference score for each audience condition and run a t-test to determine whether the variance

⁴⁵ In fact, the mean participant expectation of stakeholder preferences for each stakeholder group is significantly different (all p 's < 0.001 , two-tailed) from the response scale mid-point indicating that participants perceived each stakeholder group has a clear preference for either financial or social benefits.

Table 4: Participant Beliefs About Stakeholder Preferences**Panel A: Mean (standard deviation) responses**

Stakeholder Groups	Responses
Investors	1.65 (1.92)
Lenders	1.23 (1.81)
Communities	8.74 (1.38)
Governments	6.42 (1.77)
NGO's	7.87 (2.05)
Customers	6.37 (2.46)
Suppliers	3.05 (2.05)

Panel B: One sample t-test results

	Mean (s.d.)	Difference from scale mid-point	t- Statistic	p-Value
Capital providers	1.44 (1.66)	-3.56	-20.51	< 0.001*
Other stakeholders	6.49 (1.09)	1.49	13.05	< 0.001*

Panel C: Perceived Audience Preference Dispersion

Capital providers: Mean (s.d.)	All stakeholders: Mean (s.d.)	Mean difference	df	t-Statistic	p-Value
0.51 (0.70)	2.86 (0.68)	-2.34	89	-16.14	< 0.001*

Panel A provides mean (standard deviation) results to a post-experimental question asking participants to “indicate the response that reflects [their] belief about whether each stakeholder group would favor benefits to the environment or financial benefits”. Responses were provided for each of the seven stakeholder groups listed in Panel A and were made on an 11-point scale anchored by “Strongly favor financial benefits” (0) and “Strongly favor environmental benefits” (10), with the mid-point labelled as “Equally favor financial and environmental benefits” (5). Panel B provides results for one-sample t-tests when the mean responses in Panel A are averaged for capital providers (i.e., investors and lenders) and other stakeholders (i.e., communities, governments, NGO's customers, and suppliers). The t-test specifically tests whether the mean for capital providers and other stakeholders differs significantly from the scale mid-point of 5. Panel C reports the mean absolute deviations in participants' perceptions of each stakeholder group's preferences within their disclosure audience from their overall audience preference mean. To calculate the mean absolute deviation of each participant in the capital providers (all stakeholders) condition, I averaged each participant's response reported in Panel A for investors and lenders (investors, lenders, communities, governments, NGOs, customers and suppliers). I then calculated the absolute difference between this average and the responses for each individual stakeholder group for every participant. I then calculated the mean of this absolute deviation for each participant. Finally, I calculated an overall mean (s.d.) for this deviation in each audience condition. I then ran a t-test to determine whether the difference in this deviation between audience conditions is significant. *Indicates a one-tailed p-value to reflect my directional predictions. All other p-values are two –tailed.

between the two audience conditions is significant.⁴⁶ As indicated in Panel C of Table 4, the disclosure audience's perceived preference divergence is larger ($p < 0.001$, one-tailed) when the audience includes all stakeholders (mean = 2.86) than when it is limited to capital providers (mean = 0.51). Thus, collectively, the results reported in Table 4 support my assumptions about participants' perceptions of stakeholder preferences.

6.2 The Relative Influences of Audience and Location

In constructing my hypotheses, I predicted that the relative influences of the disclosure audience and the disclosure location on manager participants' capital allocations will be contingent on the preference uniformity of the disclosure audience. Specifically, when disclosing to a capital provider audience with a perceived uniform preference for financial benefits, I expect that the influence of the disclosure audience on capital allocations will not be affected by the disclosure location. However, when disclosing to all stakeholders with divergent preferences for financial and social benefits, I expect that the disclosure location will affect the influence of the disclosure audience by making stakeholders with preferences for financial (social) benefits more salient when disclosing in MD&A (a Sustainability Report). Consequently, the preferences of the more salient stakeholders will be more influential on participants' capital allocations than the preferences of the less salient stakeholders.

To examine these expectations, I ask participants the extent to which their allocations were influenced by the disclosure audience, conditional on location. Responses to this question are made on a 7-point scale ranging from "Significantly increased funding to [project] A" (-3) to "Significantly increased funding to [project] B" (3), with "Had no effect" as the mid-point (0). The pattern of the mean results in each condition, as depicted in Figure 4, is consistent with my

⁴⁶ This analysis assumes participants equally weighted the preference of individual stakeholder group in their disclosure audience.

expectations. Disclosure location does not appear to affect the influence of disclosure audience on participants' allocations when disclosing to capital providers but does when disclosing to all stakeholders. Further, when disclosing to all stakeholders, MD&A disclosure appears to shift the effect of audience on allocations more toward financial benefits while Sustainability Report disclosure appears to shift the influence of audience more toward social benefits.

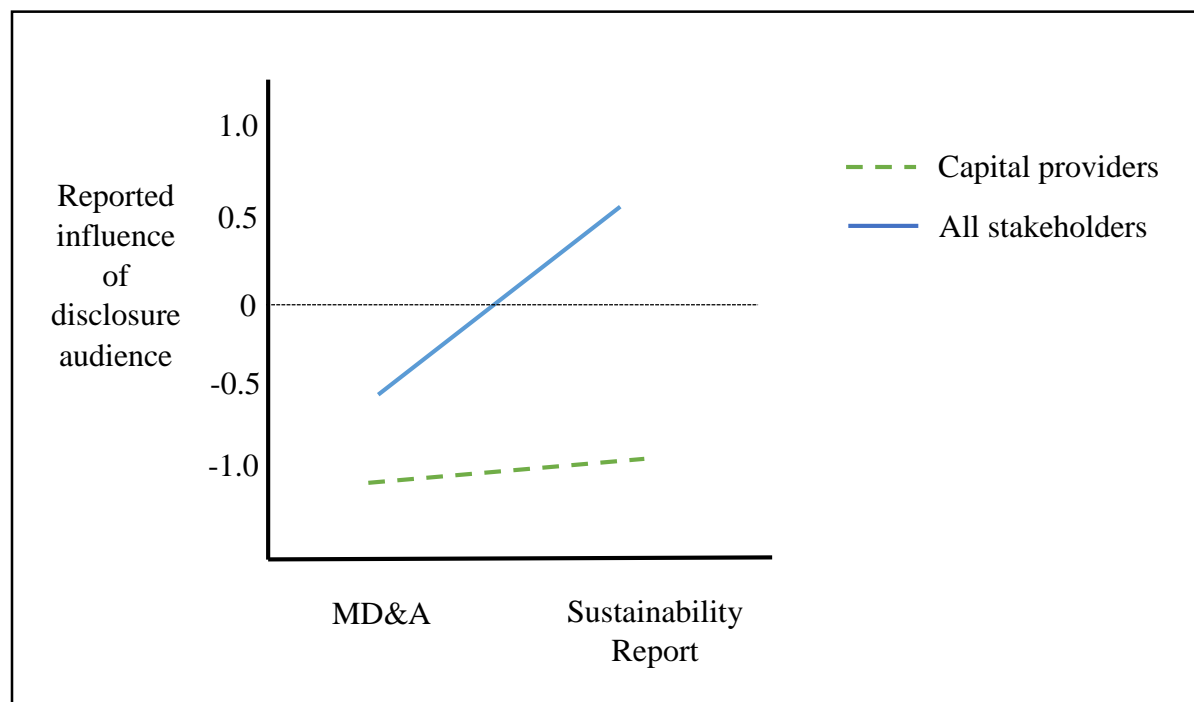


Figure 4: Influence of Disclosure Audience on Capital Allocations

Consistent with my expectations, I test for differences in mean responses to this question using a contrast coded ANOVA (Buckless and Ravenscroft, 1990) with the following weights: -1 in the capital providers/MD&A condition, -1 in the capital providers/Sustainability Report condition, -1 in the all stakeholders/MD&A condition, and +3 in the all stakeholders/Sustainability Report condition. As reported in Panel B of Table 5, the interaction is

significant ($p < 0.001$, one-tailed), and follow-up simple main effect tests reported in Panel C provide further support for my expectations. Specifically, participant responses indicate that disclosure location does not affect how influential the disclosure audience is on capital allocations when disclosing to capital providers ($p = 0.757$, two-tailed) but does have an effect when disclosing to all stakeholders ($p = 0.008$, one-tailed). This provides evidence that, when disclosing to all stakeholders, the disclosure location appears to help manager-participants interpret who their audience is by making specific stakeholder preferences within the disclosure audience for either financial or social benefits more salient and influential on managers' decisions.

Table 5: Reported Influence of Disclosure Audience

Panel A: Influence of Audience: Mean and (standard deviation)

	Disclosure location		
Disclosure audience	MD&A	Sustainability Report	Row Means
Capital Providers	-1.05 (1.56) n=21	-0.91 (0.95) n=23	-0.98 (1.27) n=44
All Stakeholders	-0.55 (1.61) n=20	0.52 (1.56) n=25	0.04 (1.65) n=45
Column Means	-0.80 (1.59) n=41	-0.17 (1.48) n=48	

Panel B: Contrast Coded ANOVA

Source	S.S.	df	M.S.	F-Statistic	<i>p</i> -value
Audience x Location	33.07	1	33.07	15.97	< 0.001*
Residual	0.36	2	0.18	0.09	0.917
Error	175.97	85	2.07		

Table 5 (continued)

Panel C: Simple Main Effects

	<i>df</i>	F-stat	<i>p</i> -value
Effect of location when audience is capital providers	1	0.10	0.757
Effect of location when audience is all stakeholders	1	6.15	0.008*

Table 5 presents descriptive statistics, contrast-coded ANOVA, and simple main effects tests for participants' capital allocations. Participants are asked to indicate the extent to which the disclosure audience influenced their capital allocations to project A and project B. Responses are made on a seven point scale, anchored by "Significantly increased funding to A" (-3) and "Significantly increased funding to B" (3), with "Had no effect" (0) as the mid-point. Two participants did not provide a response to this question—one participant was in the Capital Providers/MD&A condition and the other was in the All Stakeholders/MD&A condition. The four cells in my experiment receive the following contrast weights: capital providers/MD&A = -1, capital providers/Sustainability Report = -1, all stakeholders/MD&A = -1, all stakeholders/Sustainability Report = +3. *Indicates a one-tailed p-value to reflect my directional predictions. All other p-values are two-tailed.

6.3 Participant Perception of Location's Audience and Content

I predicted that managers will associate MD&A with financial performance and a larger capital provider audience, and a Sustainability Report with social performance and a broader stakeholder audience. To provide evidence supporting this prediction, I ask participants two questions. The first asks them to indicate the extent to which they believe the report relevant to their experimental condition (i.e., MD&A or Sustainability Report) consists of financial information or environmental information. Responses are given on an 11-point scale anchored by "Entirely financial information" (0) and "Entirely environmental information" (11), with "Equal parts financial and environmental information" as the mid-point (5). The untabulated mean response to this question in the MD&A (Sustainability Report) condition is significantly lower (greater) than the mid-point of the scale (both p 's < 0.001, one-tailed). In addition, the mean response in the MD&A condition is significantly lower than the mean response in the

Sustainability Report condition ($p < 0.001$, one-tailed). These results are consistent with my prediction.

The second question asks participants in the MD&A (Sustainability Report) condition what proportion of the stakeholders who will likely view the CSR disclosures in the MD&A (Sustainability Report) they believe are capital providers vs. other stakeholders. To answer this question, participants allocate between 0 and 100% to capital providers and to other stakeholders, and the total allocation to each must sum to 100%. The mean percentage of capital providers participants believe make up MD&A's viewership (75.84%) is significantly greater than the mean percentage of capital providers making up the Sustainability Report viewership (61.77%) ($p < 0.001$, one-tailed). Taken together, responses to these two questions support my predictions that participants are more likely to associate MD&A with financial information and a capital provider viewership compared to a Sustainability Report which they are more likely to associate with social information and a broader stakeholder audience.

6.4 Individual CSR Preferences

Prior research (Agle et al. 1999; Chin et al., 2013) indicates that managers' individual preferences for CSR can influence the level of their engagement in CSR. To increase the power of my H1 tests and control for this possibility, I ask participants to answer two questions after they make their capital allocation decisions. The first question asks them to indicate how strongly they personally believe companies should take measures to reduce their water consumption. Similarly, the second question asks them how strongly they personally believe companies should engage in socially responsible activities in general. Responses are given on an 11-point scale ranging from 0 to 10, with higher values indicating stronger beliefs that companies should reduce their water use and engage in CSR. The Cronbach's alpha for these two

measures is 0.92, suggesting the two questions are capturing the same construct. Therefore, I average the responses for these two questions to obtain a single measure of participant CSR belief. I next run the same contrast-coded ANOVA I used to test H1 but add participants' average CSR belief as a covariate.⁴⁷ Based on the high mean responses reported in Panel A of Table 6, it appears participants generally have strong CSR beliefs. As reported in Panel B of Table 6, the effect of individual CSR belief significantly influences participants' capital allocations. Importantly, the contrast-coded interaction of audience and location remains significant ($p = 0.050$, one-tailed), and the simple main effect of location is insignificant when the audience is capital providers ($p = 0.960$, two-tailed) and marginally significant when the

TABLE 6: ANOVA Results with CSR Belief Covariate

Panel A: Mean (standard deviation) Responses for CSR Belief

Capital Providers / MD&A	Capital Providers / Sustainability Report	All Stakeholders / MD&A	All Stakeholders / Sustainability Report
7.14 (2.58) n = 22	7.50 (2.58) n = 23	8.24 (1.70) n = 21	7.74 (2.12) n = 25

Panel B: Contrast Coded ANCOVA

Source	S.S.	df	M.S.	F-Statistic	p-value
CSR Belief	2379.93	1	2379.93	3.050	0.042*
Audience x Location	2164.15	1	2164.15	2.773	0.050*
Residual	40.16	2	20.08	0.026	0.974
Error	67112.99	87	780.38		

*Indicates a one-tailed p value to reflect my directional predictions. All other p values are two-tailed.

⁴⁷ Participant CSR preferences do not differ between conditions ($p = 0.452$, two-tailed, untabulated).

audience is all stakeholders ($p = 0.053$, one-tailed). Therefore, I conclude that participants' individual beliefs do influence participants' capital allocation decisions but that the joint influence of disclosure audience and location reported above are incremental to the influence of these beliefs.

CHAPTER 7

CONCLUSIONS

Two of the key features among existing CSR reporting models are which stakeholders constitute the disclosure audience and the reporting location of the CSR disclosures. Prior research has not yet examined how differences in these features influence managers' decision-making and, as a result, stakeholder welfare. Currently, more and more CSR disclosure requirements are being made by regulators and stock exchanges, creating a demand for CSR disclosure standardization. However, there is currently very little research to inform this standardization process. In this study, I seek to inform regulators, standard setters, stakeholders, and managers about the consequences of divergent CSR reporting model features by examining how managers' capital allocations are affected by the disclosure audience and location.

The results of my study suggest that the capital allocations managers make to financial and social benefits are sensitive to the CSR disclosure audience and location. Managers, on average, allocated more capital to projects that emphasized social benefits when their CSR disclosures were directed to a broad stakeholder audience and were provided in a Sustainability Report. In all other conditions, they allocated more capital to projects that emphasized financial benefits. I find that these differences in capital allocations were driven by how accountable managers felt for financial and social performance. I also provide evidence that the influence of the disclosure location on managers' allocations appears to be contingent on whether the preferences of the stakeholders in the disclosure audience are homogenous.

My study is subject to certain limitations. Specifically, I exogenously manipulated disclosure audience and location. Although mandatory CSR disclosure is increasing, disclosure

audience and location are currently predominantly endogenous choices. As such, my results may not generalize to certain endogenous disclosure settings—particularly one where the manager making the disclosure decisions is also making the capital allocation decisions. However, there are endogenous situations to which my results do likely generalize. One such situation is when, the selection of a CSR reporting model is sticky due to switching costs—which it is likely to be, at least in the short-run (Graham et al., 2005). As a result, the reporting model is effectively exogenous from one period to the next. A second situation is when capital allocations pertaining to CSR are made at different levels within a firm. In such situations, even if the CSR reporting model is viewed as being endogenous at the firm level, it would likely be exogenous at all lower levels. My research design, therefore, allows me to address not only regulatory policy implications, but also practical implications of individual firm adoption of a reporting model.

A second limitation is that I used MBA students as proxies for corporate managers. Differences in experience and expertise between my participants and corporate managers may affect the results my study. However, I find consistent results using both a traditional (MBA students) and non-traditional (Amazon Mechanical Turk workers) participant pool as proxies for managers, suggesting that at least initial levels of work experience and business education do not significantly alter my results. In addition, there is evidence to suggest that the effects of accountability signals on corporate managers may be stronger than indicated in my results. Prior research suggests that managers are likely to be high self-monitors (Gibbins and Newton, 1994; Kilduff and Day, 1994; Mehra et al., 2001), and individuals who rate high in self-monitoring are particularly sensitive to accountability influences (Lerner and Tetlock, 1999). Therefore, to the extent CSR disclosure audience and location affect managers' felt accountability, any effects of accountability detected in my study using MBA students should theoretically be stronger among

real corporate managers. Future research might examine whether differences in work experience and differences based on personality traits such as self-monitoring might lead to different capital allocation outcomes than those documented in my study.

A third limitation is that participants in my experiment were paid a flat wage. An advantage of this design choice is that it helped me to more cleanly isolate the effect of disclosure audience and location on managers' capital allocations. However, in practice, capital allocations that influence financial performance can potentially affect managers' compensation if such allocations help managers meet specific financial benchmarks. On one hand, there is reason to believe that such incentive compensation would uniformly increase the level of managers' capital allocations to projects that improve financial performance without eliminating managers' capital allocations to projects that maximize social benefits. On the other hand, I acknowledge there may also be scenarios in which incentive compensation interacts with managers' capital allocations. Future research could be useful in examining the extent to which managers' financial incentives affect their CSR decisions.

One practical implication of this study is that managers' capital allocations are heavily influenced by their perception of the preferences of capital providers. That is, the investment decisions by participants in my study seem to be largely driven by their belief that capital providers have a strong preference for financial performance over social performance. Therefore, to the extent managers would like to feel greater flexibility to allocate capital to projects that provide greater social benefits, it appears that managers need a better way of communicating the benefits of CSR to firm value, to the extent these benefits exist. Similarly, if capital providers want managers to engage in socially beneficial projects, my results suggest they need to communicate this better to managers to help them feel licensed to do so. Future research can

examine these issues. For instance, integrated reports—which are reports that explain how social performance translates into firm value over time—may be a viable option to help managers understand and communicate the link between social performance and financial performance. This, in turn, may help managers feel more comfortable allocating capital to projects that are financially costly but socially beneficial.

APPENDIX A: Experimental Instrument – Background (All Conditions)

COMPANY OVERVIEW

You are the CEO of XYZ Company, a publicly-traded company. XYZ was founded in 2003 and has become a pioneer and a global market leader in devices for the motion interface market that detect and track an object's motion in three-dimensional space. The target markets for these devices include electronics applications such as smartphones, tablets, gaming devices, and smart TVs.

XYZ recently released the results for its 2013 fiscal year. Those results, as well as the results from the two preceding years, are provided in the summarized balance sheet and income statement information on the next page.

FINANCIAL PERFORMANCE

Information from XYZ's Balance Sheet

	Fiscal Years		
	2013	2012	2011
	(in thousands)		
Current assets	\$ 245,045	\$ 186,131	\$ 65,297
Long-term assets	<u>34,049</u>	<u>7,187</u>	<u>5,449</u>
Total assets	\$ 279,094	\$ 193,318	\$ 70,746
Liabilities	\$ 29,147	\$ 16,441	\$ 11,605
Common stock	\$ 158,158	\$ 136,793	\$ 56,004
Retained earnings	<u>91,789</u>	<u>40,084</u>	<u>3,137</u>
Total stockholders' equity	\$ 249,947	\$ 176,877	\$ 59,141

Information from XYZ's Income Statement

	Fiscal Years		
	2013	2012	2011
	(in thousands, except per share data)		
Revenue	\$ 208,634	\$ 152,967	\$ 96,547
Cost of revenue	<u>(97,937)</u>	<u>(67,571)</u>	<u>(43,647)</u>
Gross profit	110,697	85,396	52,900
Operating expenses	(54,039)	(38,382)	(31,422)
Other income (expenses)	<u>(4,953)</u>	<u>(10,067)</u>	<u>(12,131)</u>
Net income	\$ 51,705	\$ 36,947	\$ 9,347
Earnings per share (EPS)	\$ 0.62	\$ 0.39	\$ 0.09

The positive growth XYZ has experienced over the last three years has been similar to the median growth rate among firms in XYZ's industry. That is, in XYZ's industry, some firms have experienced stronger growth than XYZ while an equal number of firms have experienced weaker growth.

APPENDIX B: Experimental Instrument – Capital Providers/MD&A Condition

MANAGERIAL RESPONSIBILITIES

As CEO of XYZ, you have responsibility for XYZ's corporate social responsibility (CSR) activities. Specifically, you select which CSR activities will be funded and you also make funding allocation decisions. This will be your primary task in this study and, importantly, you will be asked to explain your decisions.

In addition, you oversee the annual public reporting of XYZ's corporate social responsibility (CSR) activities. Generally, these disclosures include information about what CSR activities you have chosen and the benefits these activities provide. These disclosures, however, typically do not indicate how much capital you allocate to CSR activities.

Your CSR disclosures will be directed to the following stakeholder groups:

- **Investors** – the shareholders of XYZ
- **Lenders** – financial institutions with whom XYZ has loans and credit lines

Your CSR disclosures will be primarily communicated in the firm's annual report. The annual report is prefaced with an introductory letter written by you which includes your name and picture. Within the annual report, the CSR activities are disclosed in the **Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)**. The general purposes of MD&A are:

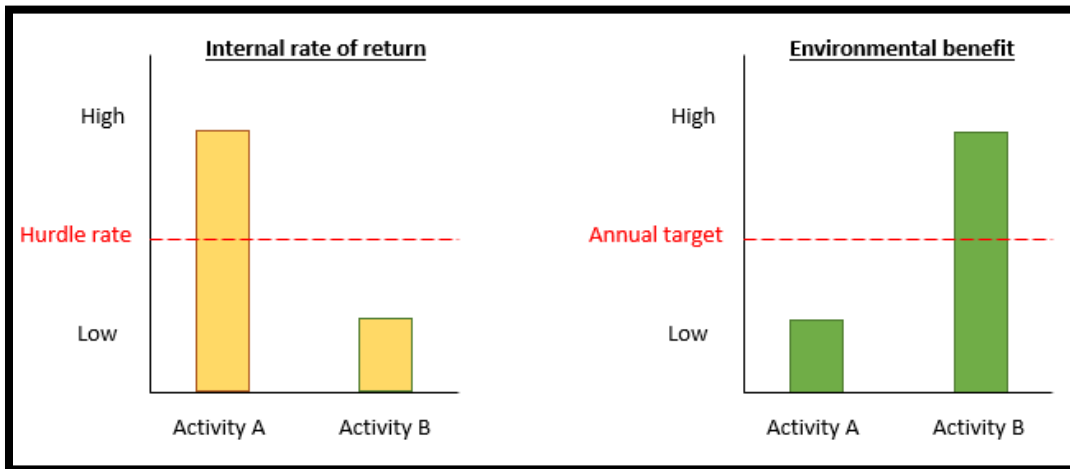
- To provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management;
- To enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- To provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.

CSR INITIATIVE

A CSR initiative XYZ is considering is reducing the volume of water used in its processes and operations. To understand the available options to accomplish this, XYZ formed a research team to examine the issue. The research team identified two specific activities you, as CEO, can choose to fund to reduce XYZ's water use: Activity A and Activity B. These two activities can be undertaken either simultaneously or independently.

The research team also calculated the expected benefits Activity A and Activity B will generate for XYZ's bottom line and the environment (via reduced water use). The analysis benchmarks these benefits against XYZ's hurdle rate (i.e., the rate of return XYZ typically requires of its capital investments) and private annual water reduction target--*neither of which are public information*. In summary:

- **Activity A** exceeds XYZ's hurdle rate but is below XYZ's annual water reduction target
- **Activity B** exceeds XYZ's annual water reduction target but is below XYZ's hurdle rate



*Please evaluate the information above with the understanding that on the following page you will be asked to:

- Allocate a fixed amount of capital between Activity A and Activity B.
- Provide an explanation of your allocation decision and its benefits for inclusion in MD&A disclosures to stakeholders (i.e., investors and lenders).

APPENDIX C: Experimental Instrument – All Stakeholders/Sustainability Condition

MANAGERIAL RESPONSIBILITIES

As CEO of XYZ, you have responsibility for XYZ's corporate social responsibility (CSR) activities. Specifically, you select which CSR activities will be funded and you also make funding allocation decisions. This will be your primary task in this study and, importantly, you will be asked to explain your decisions.

In addition, you oversee the annual public reporting of XYZ's corporate social responsibility (CSR) activities. Generally, these disclosures include information about what CSR activities you have chosen and the benefits these activities provide. These disclosures, however, typically do not indicate how much capital you allocate to CSR activities.

Your CSR disclosures will be directed to the following stakeholder groups:

- **Investors** – the shareholders of XYZ
- **Lenders** – financial institutions with whom XYZ has loans and credit lines
- **Communities** – the local residents of the cities where XYZ operates and is headquartered both nationally and internationally
- **Governments** – the local, regional, and national governments where XYZ operates and is headquartered
- **Non-governmental organizations** – private not-for-profit organizations concerned about XYZ's social and environmental impacts
- **Customers** – XYZ's global customer base
- **Suppliers** – XYZ's global supply chain

Your CSR disclosures will be primarily communicated in the firm's **Sustainability Report**. The Sustainability Report is a standalone report that is issued by XYZ annually and is prefaced with an introductory letter written by you which includes your name and picture. The general purposes of the Sustainability Report are:

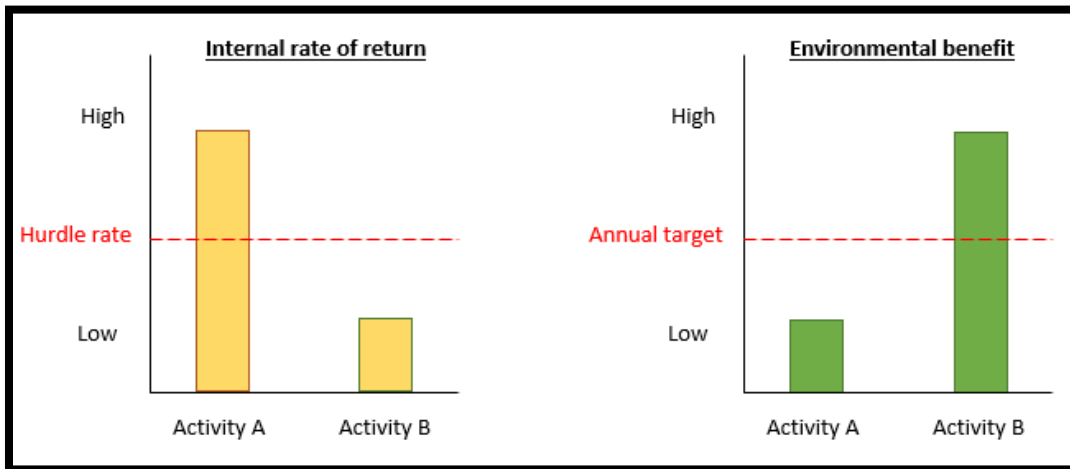
- To report the company's economic, environmental, and social impacts.
- To present the company's values and governance model, and demonstrate the link between its strategy and its commitment to a sustainable global economy.
- To help companies measure, understand and communicate their economic, environmental, social and governance performance.

CSR INITIATIVE

A CSR initiative XYZ is considering is reducing the volume of water used in its processes and operations. To understand the available options to accomplish this, XYZ formed a research team to examine the issue. The research team identified two specific activities you, as CEO, can choose to fund to reduce XYZ's water use: Activity A and Activity B. These two activities can be undertaken either simultaneously or independently.

The research team also calculated the expected benefits Activity A and Activity B will generate for XYZ's bottom line and the environment (via reduced water use). The analysis benchmarks these benefits against XYZ's hurdle rate (i.e., the rate of return XYZ typically requires of its capital investments) and private annual water reduction target--*neither of which are public information*. In summary:

- **Activity A** exceeds XYZ's hurdle rate but is below XYZ's annual water reduction target
- **Activity B** exceeds XYZ's annual water reduction target but is below XYZ's hurdle rate



*Please evaluate the information above with the understanding that on the following page you will be asked to:

- Allocate a fixed amount of capital between Activity A and Activity B.
- Provide an explanation of your allocation decision and its benefits for inclusion in the Sustainability Report disclosures to stakeholders (i.e., investors, lenders, communities, customers, etc.).

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